



AUGUST 2002

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H.R. 3763-3

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The Securities Law Institute is dedicated to implementing a system of disseminating material information relative to issuers and individuals involved in the ownership and management of public companies.

Sarbanes-Oxley Act of 2002

On July 30, 2002, President Bush signed the Sarbanes-Oxley Act of 2002 that was passed by Congress on July 25, 2002. The Act implements broad accounting and corporate governance reform. The Act is inspired by Congress' goal of improving investor confidence and restoring integrity to the capital markets. The Act authorizes \$773 million in additional funding for the SEC in fiscal year 2003 to support the SEC's implementation of various provisions of the Act. The Act also directs the SEC and other regulatory bodies to conduct studies and produce reports on various aspects of conduct in the capital markets.

The various provisions of the Act have different effective dates. A few of the Act's provisions take effect immediately; however, many of the provisions require the SEC to implement rules in the next 30 to 180 days. The provisions of the Act generally apply to U.S. public companies and non-U.S. public companies that are listed for trading on a U.S. exchange. We encourage public companies to take particular notice of the two provisions discussed below requiring CEOs and CFOs to make certifications in connection with their company's periodic reports, one of which is effective immediately. For most companies this means certification of the quarterly report due August 14, 2002. Also, Section 16 insiders of public companies should be advised that, beginning August 29, 2002, they will need to report their stock transactions by the end of the second business day following execution of a transaction, unless the SEC determines that the two-day period is insufficient and sets another time requirement.

As with any significant new legislation, further analysis will be required in order to determine how companies will need to revise their corporate disclosure and governance practices

in order to comply with the Act.

Public Company Accounting Oversight Board (PCAOB)

The Act requires establishment of the Public Company Accounting Oversight Board to oversee accounting firms that audit public companies.

Establishment of PCAOB.

The Act mandates establishment of the PCAOB, a private non-profit corporate entity, to regulate accounting firms that audit public companies. The PCAOB must be certified by the SEC within 270 days of the effective date of the Act. Audit firms will need to register with the PCAOB within 180 days after the PCAOB is certified, in order to be permitted to audit a public company.

PCAOB Membership.

The PCAOB will consist of five qualified members serving on a full-time basis who shall be appointed by the SEC. Two of the members, but no more than two, must be certified public accountants.

PCAOB Authority.

The PCAOB will be required to establish auditing and professional conduct standards. The PCAOB will be required to inspect all audit firms that audit more than 100 public companies every year and all other audit firms at least once every three years. The PCAOB will have the authority to investigate and discipline audit firms and accountants.

Funding for PCAOB.

The operations of the PCAOB will be funded in

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Published by:

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part by annual fees paid by public companies. A company's fee will be determined by its relative market capitalization.

GAAP Standards.

The SEC is empowered to designate a private organization, such as FASB, to set generally accepted accounting principles. This organization will be directed to consider accounting issues and evolving business practices and modify accounting principles accordingly.

Auditor Independence

The Act prohibits auditors from providing certain "non-audit" services to their audit clients.

Audit committees will be required to pre-approve all non-audit services provided by the audit firm.

The Act requires rotation of audit partners every five years and requires a one-year "cooling off" period between when a member of the firm who participated in a company's audit begins serving as a senior executive at the company and when the audit firm can audit the company.

Auditors are required to report certain matters directly to the company's audit committee.

The SEC will propose rules to prohibit insiders from improperly influencing auditors in connection with preparation of the company's financial statements.

Establishment of Auditor Independence Standards.

The Act requires the SEC to adopt regulations governing auditor independence. The Act itself:

- Prohibits audit firms from providing the following non-audit services to an audit client:

bookkeeping and related services; financial information systems design and implementation services; appraisal or valuation services or fairness opinions; actuarial services; internal audit outsourcing services; management functions or human resources; broker/dealer, investment adviser or investment banking services and legal services. The PCAOB may add other non-audit services to this list and may grant exemptions on a case-by-case basis.

- Requires audit committee pre-approval of all audit and non-audit services provided by the audit firm. All required audit committee approvals of non-audit services must be disclosed in the company's periodic reports.

- Prohibits an audit firm from auditing a company if either the lead or the reviewing audit partner performed audit services for the company in each of the prior five years.

- Requires audit firms to discuss certain matters with the company's audit committee, such as critical accounting policies and practices used in the audit, alternative GAAP treatments of financial information and other material written communications between the audit firm and the company's management.

- Prohibit an audit firm from auditing a company if the CEO, CFO, controller, chief accounting officer or other similar management member was employed by the accounting firm and participated in the company's audit in any capacity in the prior one-year period.

Record Retention.

The Act requires auditors to keep all audit and review workpapers for at least 7 years. The SEC is required to adopt, within 180 days of the effective date of the Act, rules that require retention of documents related to an audit or review.

Corporate Responsibility

The Act specifies additional requirements to ensure audit committee independence.

The SEC must adopt within 30 days rules requiring CEOs and CFOs to certify each quarterly and annual report filed with the SEC.

The Act requires CEOs and CFOs to forfeit certain bonuses and incentive compensation received during the 12 months following the filing of a report if the financial statements in the report need to be restated due to misconduct.

The Act lowers the threshold for barring officers and directors from serving as such from "substantial unfitness" to "unfitness".

The Act prohibits officers and directors from trading in a company's stock during a pension fund "blackout" period.

Within 180 days the SEC must issue rules requiring lawyers who represent public companies to report evidence of material securities law violations or other similar breaches to the CEO or chief legal officer of the company, and then to the audit committee or the full board if executives fail to take appropriate action.

Improper Influence on Audits.

The Act prohibits officers and directors from influencing, manipulating or misleading auditors so as to cause the financial statements to be materially misleading in violation of the SEC's financial reporting rules.

Responsibilities and Independence of Audit Committees.

The Act requires audit committees to be directly responsible for the appointment, compensation and oversight of the company's audit firm, including resolving any disagreement between the audit firm and management on financial reporting matters. Audit committee members must be "independent" from management, meaning that audit committee members cannot accept any fees from the company other than for services rendered as a board or committee member, and must not be "affiliated persons" of the company or its subsidiaries. The Act grants authority to audit committees to engage independent counsel and other advisers and requires public companies to provide sufficient funding to the audit committee to carry out its responsibilities.

Protection for "Whistleblowers"

The Act requires audit committees to establish procedures to handle employee complaints about the company's accounting or auditing matters and to protect the confidentiality of employees who raise such concerns.

Possible Delisting.

The Act directs the SEC to adopt a rule under which the securities exchanges would be required to refrain from listing a security of a public company that does not comply with certain audit committee requirements.

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Certifications by CEOs and CFOs.

The Act directs the SEC to adopt rules requiring CEOs and CFOs, in connection with each Form 10-Q and Form 10-K, to certify in writing that:

- The officer reviewed the report;
- Based on the officer's knowledge, the report does not contain any untrue statement or omission of a material fact;
- Based on the officer's knowledge, the financial statements and other financial information fairly present in all material respects the company's financial condition and results of operations for the periods presented;
- The officers are responsible for establishing and maintaining internal controls that are designed to provide them with material information about the company;
- The officers evaluated the effectiveness of the company's internal controls within 90 days prior to filing the report;
- The officers disclosed to the auditors and audit committee all significant internal control deficiencies and any fraud involving persons who have a significant role in internal controls; and
- The officers indicated in the report whether there were significant changes in internal controls since the last evaluation.

In addition, a separate section of the Act (Section 906) appears to create an immediate certification obligation for CEOs and CFOs. This separate certification requires CEOs and CFOs to certify that each periodic report containing financial statements fully complies with the Exchange Act requirements, and that the information in the report fairly presents, in all material respects, the financial condition and results of operations of the public company. Violations of this criminal provision are punishable by fines and/or imprisonment.

Disbursement of Bonuses and Profits.

The Act requires CEOs and CFOs to forfeit any bonuses or other incentive-based or equity-based compensation, and any profits from sales of the company's securities, received in the 12 month period that follows the filing of a report for which the financial information must subsequently be restated due to misconduct that causes the company to be in material noncompliance with any financial reporting requirement of the securities laws.

Standard for Barring Officers and Directors.

The Act lowers the standard for barring persons from serving as officers or directors of public companies from "substantial unfitness" to "unfitness". The Act increases the SEC's ability to prohibit a person who has violated any anti-fraud provisions of the federal securities laws from serving as an officer or director of a public company.

Prohibition Against Insider Trades During Blackout Periods.

The Act makes it unlawful for any executive officer or director of a company to effect any transactions in any company equity security during any pension plan blackout period if the officer or director acquired the security in connection with his or her service as an officer or director. Any unlawful profits from trades during blackout periods are recoverable by the company. In order to facilitate this restriction, plan administrators are required to give at least 30 days written notice to plan participants of any blackout period involving an individual account plan (such as a 401(k) plan).

Professional Responsibility of Attorneys.

The Act requires the SEC to issue rules establishing professional conduct standards for attorneys appearing and practicing before the SEC in the representation of public companies. The standards will require attorneys to report evidence of material violations of securities laws or fiduciary duties to the company's CEO or chief counsel. If adequate measures are not taken by the executives, then the attorneys must report to the company's audit committee or another committee comprised solely of independent directors, or to the full board.

Use of Disgorged Funds.

The Act permits the application of civil penalties and disgorged funds to provide restitution to injured investors.

Enhanced Financial Disclosures

Within 180 days, the SEC must issue rules requiring disclosure of material off-balance sheet transactions and relationships with unconsolidated entities, and enhanced disclosure of pro forma financial information.

Public companies are prohibited from extending or arranging personal loans to their officers and directors.

Insiders are required to report securities transactions on a more expedited basis.

Management must assess and disclose its assessment of the company's internal control structure.

Companies will need to disclose whether they have adopted a code of ethics to govern the company's senior management, and if not, why not, and to disclose any waivers of the code provisions.

Companies will be required to disclose whether a financial expert is serving on the company's audit committee, and if not, why not.

Periodic Disclosures.

The Act directs the SEC to issue rules that require disclosure in a company's periodic reports of material off-balance sheet transactions and relationships with unconsolidated entities that may have a material effect on financial condition or results of operations. The SEC must also issue rules governing any public disclosure of pro forma financial information (including press releases), such results to require that the pro forma information not be misleading and be reconciled to the company's GAAP financial information.

Prohibition of Personal Loans to Executives.

Effective immediately, the Act prohibits public companies from making new loans, extending credit or arranging for the extension of credit to any director or executive officer. Existing loan or credit arrangements are not prohibited, but the Act bars renewing or making any material modification to such arrangements. Exceptions are available for certain consumer loans that are made in the ordinary course on terms no more favorable than those available to the general public, margin loans by SEC registered broker-dealers to their employees and loans by FDIC insured financial institutions that are subject to existing bank regulatory restrictions.

Section 16 Reporting.

Effective 30 days after the effective date of the Act, Section 16 filers will be required to report stock transactions of the type reported on Form 4 by the end of the second business day after the execution of the transaction (unless the SEC determines that period is not feasible), rather than within 10 days of the end of the month in which the transaction occurs, as is currently the case. Under the SEC's current proposed rules, fewer transactions will be exempt from reporting

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than is currently the case. Starting no later than one year from the effective date of the Act, Section 16 filings must be made electronically and posted on the company's web site.

Assessment of Internal Controls.

The Act requires the SEC to adopt rules that require management of public companies to include in each annual report an "internal control report" that sets forth the responsibility of management for establishing internal controls and contains an assessment of the company's internal control structure. The report will also require acknowledgement by the company's accounting firm.

Code of Ethics.

The SEC is directed to adopt rules, within 180 days of the effective date of the Act, requiring public companies to disclose whether they have a code of ethics governing senior financial officers and, if not, the reasons for the omission. The SEC rules will also require immediate disclosure of any change in or waiver of the code of ethics.

Disclosure of Financial Expert.

The Act also directs the SEC to require disclosure by public companies of whether the company's audit committee includes at least one "financial expert" and, if there is no financial expert, to explain why not.

Current Disclosures.

The Act requires the SEC to adopt rules mandating that companies disclose in plain English on a "rapid and current basis" any information concerning material changes in the company's financial condition or operations. These current disclosures will likely require

reporting additional events on Form 8-K.

Increased SEC Review.

The Act requires the SEC to review disclosures by public companies on a more routine basis, with a review of each company at least once every three years. The frequency of review will depend on certain factors, such as market capitalization, past restatements and stock price volatility, that characterize the company.

Analyst Conflicts of Interest

The SEC is required to adopt rules to enhance protections against conflicts affecting securities research.

The SEC is directed to adopt rules to increase public confidence in securities research by protecting the objectivity and independence of stock analysts. The rules will include provisions that:

- require public disclosure in analyst reports of any investment banking relationship between the analyst's firm and the company that is the subject of any report;
- prevent investment bankers from supervising analysts; and
- impose "blackout" periods on analysts that prevent them from publishing research on companies if the analyst's firm has served as an underwriter for the company.

Other Provisions

Criminal Provisions.

The Act imposes or increases fines and/or sentences for altering, destroying or falsifying documents to impede a governmental

investigation, destroying audit or review workpapers, participating in mail or wire fraud, conspiring to commit a fraud offense, violating ERISA, retaliating against "whistleblowers", violating the securities laws and violating the CEO/CFO certification requirements.

Civil Penalties.

The Act extends the statute of limitations for private securities fraud actions (to the earlier of 5 years after the fraudulent action or 2 years after the fraud was discovered). The Act also prevents persons declaring bankruptcy from discharging liabilities due to violations of federal or state securities laws. The Act empowers the SEC to request a court order requiring the escrow, for a limited period of time, of certain extraordinary payments (including compensation) to any officer, director or other person under investigation for securities law violations.

Sentencing Guidelines.

The Act mandates review of the sentencing guidelines for various offenses to determine whether the sentences are sufficient deterrents to fraud and other white-collar crimes.

Signatures on Corporate Tax Returns.

The Act expresses the sense of the Senate, without requiring by law, that federal income tax returns filed by a company should be signed by its CEO.

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