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Sarbanes-Oxley Act of 2002

Foreign Private Issuers, Foreign Auditors and Foreign Counsel, Privately-Held Corporations and Not-for-Profit Corporations

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Introduction

The Sarbanes-Oxley Act of 2002, known to all as "Sarbanes-Oxley," passed in July 2002, was the U.S. Congressional reaction to Enron, Worldcom, and the other corporate failures experienced in America beginning in the fall of 2001. Passed in haste, the new law left most details for further rule enactment, under an extremely rigorous time schedule, by the U.S. Securities and Exchange Commission.

Since Sarbanes-Oxley, the U.S. securities self-regulatory organizations, including the New York Stock Exchange and the Nasdaq Stock Market, have also implemented very significant changes to their own corporate governance standards.[1]

In general, Sarbanes-Oxley applies equally to U.S. exchange-listed or Nasdaq-traded entities, whether U.S. or foreign-based. Certain of the law's provisions apply as well to privately-held and not-for-profit corporations, unincorporated groups, and individuals.

The SEC's rules have crafted certain exceptions to accommodate foreign laws and practices, but the law and regulations nonetheless encountered very active opposition from foreign companies, audit firms, and lawyers, to the point that several proposed U.S. listings by significant foreign corporations have been cancelled or deferred, and there have been numerous instances of smaller U.S. publicly-held companies announcing or effecting plans to go private to avoid the substantial expense of Sarbanes-Oxley compliance. Many smaller foreign companies traded in the U.S. have initiated the process, itself burdensome and expensive, to delist and deregister in order to escape what they consider to be the excesses of the new law,[2] and the SEC

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[1] IOSCO, the International Organization of Securities Commissions, has issued a series of statements of principles for improved disclosure and auditor independence and oversight, conflicts of interest associated with securities analysts and the activities of credit agencies. Available at http://www.iosco.org. In September 2004, the European Commission announced a broad strategy for reducing corporate malpractice. The strategy reinforces four lines of defense: (i) internal controls within a company; (ii) effective independent audits; (iii) enhanced supervision by regulators; and (iv) effective criminal and other enforcement activity. The new strategy is in addition to the Financial Services Action Plan and the Action Plan for Company Law and Corporate Governance, which already provide a framework for dealing with the issues raised in the recent financial scandals. The strategy can be found at: http://www.europa.eu.int/comm/internal_market/en/company/financialcrime/index.htm

[2] "Citing Sarbanes, Foreign Companies Flee U.S. Exchanges," *Wall St. J.*, September 20, 2004, p. C-1, col. 2.

is proposing somewhat easier delisting and deregistration procedures under pressure from European regulators and industry groups.

As Sarbanes-Oxley has come into full force with the enabling regulations, the separate issue has emerged of the extent to which privately-held and not-for-profit corporations, and foreign publicly-held companies, should endeavor to comply with the various requirements of the new legislation to which they are not expressly subject. As discussed below, the principal issue militating against voluntary compliance with Sarbanes-Oxley is that compliance is extremely expensive, and requires a very significant dedication of Board and management time and attention, and therefore is strongly resisted by organizations which are not subject to the new law and which are otherwise confident regarding the accuracy and sufficiency of their financial statements and other material aspects of their operations.

The principal other and obvious distinction is that the directors and principal officers of privately-held businesses often are themselves the controlling shareholders or their direct nominees, and therefore the actual and perceived conflicts of interest which arise between directors and officers of public companies and their public shareholders either do not exist, or are immediately remediable if they do arise.

With non-profits, directors are often volunteers who serve without pay, and have demanding other commitments, and therefore the extraordinary demands which substantial Sarbanes-Oxley compliance involves would disable many otherwise willing directors from service.

What follows is a summary of the principal provisions of Sarbanes-Oxley and the regulations to date, with comments on their applicability to the foreign private issuers to which the law applies, and comments as well on the issues of voluntary compliance encountered by privately-held and not-for-profit corporations.

In addition, this Advisory covers certain Board and audit committee requirements of the NYSE and Nasdaq, and their applicability to foreign private issuers, with comments on their advisability for adoption by private companies and not-for-profits.

Applicability of Sarbanes-Oxley in General

Sarbanes-Oxley is an intensely thoroughgoing law intended to affect all public companies (and those in the active registration process), including foreign companies traded on Nasdaq or exchange-listed in the U.S., and their directors, officers, auditors and counsel. Other possible targets of interest, including the investment bankers and the rating agencies, were designated for further study, as was the effectiveness of prior regulation and enforcement efforts. The reports published to date include the reports on (i) credit rating agencies; (ii) securities professionals; (iii) methods of restitution for injured investors; (iv) enforcement actions involving reporting violations and restatements of financial statements; (v) investment banks; (vi) principles-based accounting and (vii) consolidation of accounting firms and ways to increase competition.

The new law broadly covers four areas, Auditor Oversight,[3] Corporate Governance, Accountability (of Principal Officers, Attorneys, Auditors, Research Analysts, and Credit Rating Agencies), and Disclosure.

Many of Sarbanes-Oxley's provisions were effective immediately in August 2002, and others phased in over the succeeding months and as regulations were crafted by the SEC. At the same time, the major exchanges and Nasdaq have instituted their own reforms, and the criminal and civil litigation underway involving the companies and their officers and advisors has also refined and intensified the applicable standards of conduct.

Broadly, most of the provisions of Sarbanes-Oxley apply to the approximately 1,300 non-U.S. public companies that are required to file periodic reports with the SEC, including all non-U.S. companies which file annual reports on Form 20-F, or on Form 40-F under the Canadian Multi-Jurisdictional Disclosure System.

Companies with unlisted ADRs which furnish information pursuant to Rule 12g3-2(b) of the Securities Exchange Act of 1934 (the "Exchange Act") generally are not subject by that reason alone to the new law. However, certain types of ADRs, which are listed on a U.S.

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[3] In May 2003, the European Commission proposed ten priorities for improving and harmonising the quality of statutory audit throughout the EU, available at:
http://europa.eu.int/eur-lex/en/com/cnc/2003/com2003_0286en01.pdf. In March 2004, the European Commission presented a proposal for a directive of the European Parliament and the Council of Statutory Audits on Annual and Consolidated Accounts.

exchange or market are subject to Sarbanes-Oxley because the company registers the underlying securities under § 12 of the Securities Exchange Act of 1934.

The auditor oversight and independence provisions apply to all accounting firms, wherever located, that audit domestic companies or foreign private issuers subject to the new law.

With respect to privately-held companies, many provisions of Sarbanes-Oxley become applicable upon the filing of a registration statement under the Securities Act of 1933, even if subsequently withdrawn, and private companies with publicly-held debt securities are subject to many significant aspects of the new law. Companies with IPOs in their reasonably foreseeable future are well advised to initiate Sarbanes-Oxley compliance at least one full audit year prior to their SEC filing, so that underwriters and investors (and the SEC) will be secure in the knowledge that all recent financial statements have been subject to the various rigors of the new legislation and regulations. Private companies also often pass through several rounds of institutional financing as they develop, and these professional investors and lenders as well look for Sarbanes-Oxley compliance in their analyses of prospective venues for their funds, as do public companies in their evaluation of potential acquisition candidates. Private companies audited by one of the "Big Four" audit firms have also been pressured to comply with significant aspects of the new law, especially with the trend by the largest auditors to trim their client lists in response to the demands of Sarbanes-Oxley compliance from their larger public company clients.

Furthermore, a number of significant provisions of Sarbanes-Oxley, discussed further below, apply with equal force to privately-held and even to not-for-profit corporations, and their respective officers and directors in appropriate cases, including the document destruction provisions, the increased penalties for securities fraud, and the white-collar crime, employee protection, and ERISA liabilities and penalties. Whistleblowers are protected against anyone retaliating against them or interfering with their employment for reporting truthful information about the commission of a possible federal offense to a law enforcement officer. The prohibitions against trading during ERISA plan blackout periods extend to all plans, whether or not sponsored by a public company.

It is also accepted now that, while Sarbanes-Oxley has been criticized in many quarters as an extremely expensive over-reaction to Enron and the like, its requirements have arrived and many of them are now assumed as the benchmark for best corporate governance practice for public and substantial private and not-for-profit corporations alike, especially if the non-profit company has outstanding significant bank debt or other outside financing. As a result, many of the specific prohibitions of the new law have become popular voluntary additions to the business practices of private and non-profit corporations, such as independent boards and audit, compensation and nominating committees, executive officer and director loan restrictions, ethics codes, and limits on auditors' services. However, the more expensive and time-consuming requirements of Sarbanes-Oxley, specifically the internal control and disclosure controls and procedures, have been resisted by organizations not legally required to adopt them, because of the significant expense and devotion of Board and management attention which is required for full compliance.

With the intense rounds of rule-making by the SEC, virtually all of the Sarbanes-Oxley provisions are now in effect, while a few require the SEC to adopt further rules before they will come into full force. Although the SEC has the power to exempt non-U.S. reporting companies from some of the provisions of Sarbanes-Oxley, the SEC has not yet done so except in certain limited instances, and it will take time before it might do so with respect to other provisions, if ever.

In general, foreign private issuers to which the law applies are subject to the same CEO and CFO certifications in their Forms 20-F and 40-F as are U.S. companies in their Forms 10-K. The same executive loan prohibitions apply, as do the stringent audit committee and auditor independence requirements, the specific revised financial disclosures, the controversial rules applicable to SEC counsel, and the improved whistleblower protections. And the penalties are the same for violations by U.S. and non-U.S. persons alike. While private and non-profit corporations are not subject to these provisions, they are nonetheless becoming standard corporate governance fare in significant respects for the more substantial non-profits.

Finally, a number of states have followed Sarbanes-Oxley by enacting "Mini-Sarbox" amendments to their own laws regulating the corporate governance of companies incorporated (or in some cases doing business) in the particular state.

United States Sentencing Guidelines

At the same time as Sarbanes-Oxley has been coming into full force, the United States Sentencing Commission has proposed to amend its existing organizational sentencing guidelines to make more stringent the guidelines' criteria for effective compliance and ethics programs.

The Commission, an independent agency in the federal judicial branch, was fully organized in 1985 to develop a national sentencing policy for the federal courts; Congress believed that sentencing had become too arbitrary, and that similar criminals should receive similar sentences. The Sentencing Commission's guidelines for sentencing organizations became effective on November 1, 1991. Since nationwide implementation, federal judges have sentenced approximately 650,000 defendants under the guidelines.

In April, 2004, the Commission proposed changes to the Guidelines to be effective in November, 2004 unless Congress acts against them or unless judicial issues intervene.[4] The changes make the standards for "***Effective Compliance and Ethics Programs***," which can mitigate sentences if they are in place and are observed. The standards are more rigorous and put greater responsibility on Boards of Directors and executives for the oversight and management of compliance programs. In particular, directors and executives now must create a "culture of compliance" and take an active, ongoing leadership role for the content and operation of compliance and ethics programs.

Companies that seek reduced criminal fines now must demonstrate that they have identified areas of risk where criminal violations may occur, trained high-level officials as well as employees in relevant legal standards and obligations, and given their compliance officers sufficient authority and resources to carry out their responsibilities. The Commission also determined that there may be limited situations where an organization may need to waive its attorney-client privilege to qualify for a full potential fine reduction.

These amendments represent the first time the organizational sentencing guidelines have been modified in their history. Some of these modifications are the result of recommendations of

[4] In its June 2004 decision in *Blakely v. Washington*, the Supreme Court struck down a State sentencing procedure on grounds that question the continued legality of the federal guidelines, an issue which is expected to be resolved early in the Court's new term.

the Ad Hoc Advisory Group on the Organizational Sentencing Guidelines or are the result of the enactment of Sarbanes-Oxley (§805), so they are an important parallel line of requirements to consider for public, private, and non-profit corporations alike.

Under the existing sentencing guidelines, an organization is precluded from mitigation of its sentence if it fails to self-report criminal misconduct to the authorities in a timely fashion, or if executive or management level officials tolerated or were involved in illegal activities. Failure to follow applicable government regulations and industry standards and recurrence of similar misconduct undermine an organization's eligibility for compliance credit under the federal sentencing scheme. The guidelines mandate high fines for organizations that have no meaningful programs to prevent and detect criminal conduct, or in which management was involved in the crime.

The standards and procedures enunciated in the Guidelines will be strong evidence at least that the analogous requirements of Sarbanes-Oxley have been satisfied, and that management and the Board have satisfied generally their fiduciary obligations under applicable law.

Section 404 of Sarbanes-Oxley, which has been called the "heart" of the new law, and which is discussed further below, requires an annual report statement regarding the company's internal control over financial reporting. Management must accept responsibility for establishing and maintaining an adequate internal control structure and procedures for financial reporting; and assess, as of the end of the most recent fiscal year, the effectiveness of the company's internal control structure and procedures. Management's quarterly certifications under section 302 must attest the performance of quarterly evaluations of changes that have materially affected or are reasonably likely to materially affect the company's internal controls over financial reporting.

Section 805 of Sarbanes-Oxley directed the Sentencing Commission to review and amend its organizational guidelines to ensure that they were "sufficient to deter and punish organizational criminal misconduct." In summary, the compliance programs effectively mandated by the Sentencing Guidelines are an integral component of arbanes-Oxley compliance, but are no less important for private companies or non-profits which may someday fall afoul of

criminal liabilities and seek mitigation of their organizations' sentences, or which may be faced with claims against their directors or officers alleging failure to satisfy fiduciary obligations. [5]

An "***Effective Compliance and Ethics Program***" under the Guidelines must be designed and operated with care, and its creation and implementation are beyond the scope of this Client Advisory. However, the following 7 core features must be present to satisfy the Guidelines:

1. The organization must "establish standards and procedures to prevent and detect criminal conduct;"
2. The organization's governing authority must be knowledgeable about the content and operation of the compliance and ethics program, and specific individuals with adequate resources, authority and access must be assigned overall and day-to-day responsibility and must report periodically to high-level personnel and to the governing authority;
3. The organization must use reasonable efforts not to include within its "substantial authority personnel" persons whom the organization knows, or should know, have "engaged in illegal activities or other conduct inconsistent with an effective compliance and ethics program;"
4. The organization must communicate periodically and in a practical manner its standards and procedures to the governing authority, to high-level personnel, to substantial authority personnel, and, as appropriate, to the organization's agents;
5. The organization must take reasonable steps to ensure that the program is followed, including monitoring and auditing to detect criminal conduct, to evaluate the program periodically, and to have and publicize a system for employees and agents to report potential or actual criminal conduct without fear of retaliation;
6. The organization must promote the program and enforce it consistently through appropriate incentives and disciplinary measures; and

[5] See *In re Caremark International Inc. Derivative Litigation*, 698 A.2d 959, 967 (Del. Ch. 1996), and *McCall v. Scott*, 250 F.3d 997 (6th Cir. 2001) regarding the effect of compliance programs on satisfaction of fiduciary obligations. Under the Justice Department's "Principles of Federal Prosecution of Business Organizations," the existence of a compliance program is also a significant factor in deciding whether to prosecute in the first instance.

7. After criminal conduct has been detected, the organization must take reasonable steps to respond appropriately and to prevent further similar conduct, including making any necessary modifications to the program.

Because Effective Compliance and Ethics Programs can be of such critical importance not only to Sarbanes-Oxley compliance but also to the decision whether to prosecute an organization and to the penalties resulting from criminal conduct, the desirability for such programs clearly extends beyond the entities specifically subject to the legislation to private companies and not-for-profits as well.

Public Company Accounting Oversight Board

Sarbanes-Oxley (§ 101) created a new, private sector, non-profit self-regulatory corporation, the "Public Company Accounting Oversight Board,"[6] to oversee all auditors of public companies. On October 25, 2002, the SEC appointed the five-member PCAOB which then, after a difficult initiation, became organized and effective on April 25, 2003, with the SEC's determination that the PCAOB had the capacity to meet the requirements of Sarbanes-Oxley.

Auditing Standard No. 2 Section 404(a) of Sarbanes-Oxley and the SEC's implementing rules require annual management assessments on the effectiveness of the company's internal control over financial reporting. Section 404(b) of Sarbanes-Oxley provides that a company's registered public accounting firm must attest to and report on the assessment of internal control made by management. The auditor's "attestation" report provides the public an independent reason to rely on management's description of the company's internal control over financial reporting. Such attestation must be made in accordance with standards for attestation engagements adopted by the PCAOB. On March 9, 2004, the PCAOB issued Auditing Standard No. 2, which provides such standards, and the SEC approved Auditing Standard No. 2 on June 17, 2004. Under Auditing Standard No. 2, the auditor's report on internal control over financial reporting will express two opinions: (i) an opinion on whether management's assessment of the effectiveness of internal control over financial reporting as of the end of the most recent fiscal

[6] The Public Company Accounting Oversight Board is commonly referred to as the PCAOB, and it's website is available at http://www.pcaobus.org.

year is fairly stated, and (ii) an opinion on whether the issuer has maintained effective internal control over financial reporting as of that date.

If the auditor concludes that a "material weakness" exists, the auditor must express an adverse opinion on the effectiveness of internal control over financial reporting. Auditing Standard No. 2 defines "material weakness" as a significant deficiency, or a combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. A "significant deficiency" is defined as a control deficiency, or combination of control deficiencies, that adversely affects the company's ability to initiate, authorize, record, process or report external financial data reliably in accordance with GAAP such that there is more than a remote likelihood that a misstatement of the company's annual or interim financial statements that is more than inconsequential will not be prevented or detected. A "control deficiency" exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis.

The PCAOB has published Frequently Asked Questions relating to Auditing Standard No. 2 in October and June of 2004.[7]

Registration Section 102 of Sarbanes-Oxley prohibits accounting firms that are not registered with the PCAOB from preparing or issuing audit reports on U.S. public companies or from participating in these activities. In addition, any public accounting firm that plays a substantial role in the preparation or furnishing of an audit report must register with the PCAOB. Section 106(a) of Sarbanes-Oxley provides that any non-U.S. public accounting firm that prepares or furnishes an audit report with respect to any U.S. public company is subject to the PCAOB's rules to the same extent as a U.S. public accounting firm. Further, Section 106(a) authorizes the PCAOB to require the registration of non-U.S. public accounting firms that do not issue audit reports, but that play a substantial role in their preparation. The PCAOB's rules relating to registration provide that accountants that perform the majority of the audit procedures with respect to a subsidiary or component of any company (the assets or revenues which

[7] The PCAOB staff questions and answers are available at:
http://www.pcaobus.org/Standards/Staff_Questions_and_Answers/index.asp

constitute 20% or more of the consolidated assets or revenues of such issuer) necessary for the principal accountant to issue an audit report on the issuer will be deemed to have played a substantial role in the preparation of the audit report and thus required to required to register with the PCAOB.

The PCAOB rules required the registration of U.S. public accounting firms by October 2003 and the registration of non-U.S. public accounting firms by July 2004. As of December 31, 2003, the PCAOB has approved the registration of 735 firms.

Inspections Section 104 of Sarbanes-Oxley requires the PCAOB to conduct a continuing program of inspections. During these inspections, the PCAOB assesses compliance with Sarbanes-Oxley, the rules of the PCAOB, the rules of the SEC and professional standards. Immediately after its effectiveness, the PCAOB began limited inspections of the "Big Four" auditing firms[8] remaining after the Enron-related collapse of Arthur Andersen.[9] In October 2003, the PCAOB adopted rules for annual inspections of audit firms with more than 100 public company clients and three-year minimum frequency inspections for others. PCAOB offices are now operating in Washington, New York, Atlanta, Dallas and San Francisco, and the annual budget is over $100 million and quickly rising.

Investigations The new Board is empowered to investigate public accounting firms and associated persons of such firms for rule and law violations, as well as to discipline, fine, and suspend or revoke the registration of the firm (§ 105). The PCAOB adopted rules relating to investigations and adjudications, and the SEC approved the rules on May 14, 2004. Under the rules, the PCAOB and its staff may conduct investigations concerning any acts or practices, or omissions to act, by registered public accounting firms and persons associated with such firms that may violate Sarbanes-Oxley, the PCAOB's rules, the provisions of the securities law relating to the preparation of audit reports or professional standards. Registered public accounting firms and their associated persons must cooperate with PCAOB investigations. The rules also allow the PCAOB to seek information from other persons, including clients of

[8] Deloitte & Touche LLP, Ernst & Young LLP, KPMG LLP, and PricewaterhouseCoopers LLP
[9] The inspections identified significant issues and quality control concerns but concluded that the firms were "capable of the highest quality auditing." The Board's statement and the inspection reports are available under "Inspections" at www.pcaobus.org/Inspections.

registered firms. When the PCAOB discovers violations, it will provide an opportunity for a hearing and in appropriate cases, impose sanctions designed to deter a recurrence. Sanctions may be severe, such as revoking a firm's registration or barring a person from participating in audits of public companies. The PCAOB can also impose lesser sanctions, such as imposing monetary penalties and requiring additional educational training.

Non-U.S. Public Accounting Firms On August 30, 2004, the SEC approved the PCAOB's rules relating to oversight of non-U.S. registered public accounting firms. Under Sarbanes-Oxley as drafted, non-U.S. registered public accounting firms are subject to PCAOB inspections and investigations to the same extent as U.S. registered public accounting firms. The PCAOB's rules provide that, in conducting its inspections and investigations of non-U.S. firms, the PCAOB, in appropriate circumstances, may rely on the work of non-U.S. oversight systems, based on PCAOB's analysis of the independence and rigor of that home country oversight system. The rules supplement, rather than replace or supersede, the PCAOB's existing rules with respect to inspections and investigations of registered public accounting firms, which apply to both domestic and foreign registered public accounting firms.

With respect to inspections, the PCAOB's rules establish a cooperative framework that uses a "sliding scale" approach, in which the degree of reliance the PCAOB will place on a firm's home country oversight system will vary depending on the PCAOB's analysis of that system. The PCAOB will determine the degree, if any, to which it may rely on an inspection conducted pursuant to a non-U.S. firm's home country oversight system. After making that determination, the PCAOB, to the extent consistent with its responsibilities under Sarbanes-Oxley, will conduct its own inspection of the firm in question in a manner that relies on the non-U.S. oversight system to the degree the PCAOB has determined to be appropriate.

In making its determination, the PCAOB will evaluate information concerning the home country oversight system's level of independence and rigor, including (1) the adequacy and integrity of the oversight system, (2) the independence of the system's operation from the auditing profession, (3) the nature of the system's source of funding, (4) the transparency of the system, and (5) the system's historical performance. The rules contain examples of the criteria the PCAOB might apply in determining the appropriate level of reliance to place on a non-U.S.

oversight system. The rules also provide that the PCAOB's evaluation of the appropriate degree of reliance to place on a non-U.S. oversight system will be based on its discussions with the appropriate oversight authority within that system, including discussions concerning the specific inspection work program proposed for the firm in question.

With respect to investigations of conduct that may violate laws in both the United States and a foreign jurisdiction, the rules as adopted provide that, in appropriate circumstances, the PCAOB may rely on a non-U.S. oversight authority's investigation or sanction of that firm. The PCAOB's reliance would depend in part on its assessment of the independence and rigor of the non-U.S. oversight system and also may depend on the oversight authority's willingness to update the PCAOB regarding the investigation on a regular basis and its authority and willingness to share relevant evidence with the PCAOB.

The PCAOB's rules as adopted also provide that the PCAOB may, as it deems appropriate, provide assistance to non-U.S. oversight authorities that are conducting inspections or investigations of U.S. registered public accounting firms pursuant to a non-U.S. oversight system. The rules provide that, in determining the extent of the assistance it will provide, the PCAOB may consider the independence and rigor of the non-U.S. oversight system that has requested the PCAOB's assistance. The PCAOB published Frequently Asked Questions relating to non-U.S. accounting firms.[10]

Auditors as Consultants

Sarbanes-Oxley entered and largely resolved the long-standing debate over auditors as consultants. After a phase-in period, auditors now cannot perform designated "non-audit services" for a public company client contemporaneously with their audit (§ 201), and may perform other non-designated services, including tax advice, only with advance approval of the audit committee and with appropriate disclosure in the company's SEC reports. These proscriptions are broadly in line with the pre-existing SEC auditor independence rules.

[10] The PCAOB's Frequently Asked Questions relating to non-U.S. accounting firms are available at: http://www.pcaobus.org/FAQ-NonUs-20040311.pdf.

The rules now adopted provide that unless the non-audit services were contracted for prior to May 6, 2003 (and are completed within one year of May 6, 2003) the auditor may not perform:

- Bookkeeping or other services related to the accounting records or financial statements of the audit client;
- Financial information systems design and implementation services;
- Appraisal or valuation services, fairness opinions, or contribution-in-kind reports;
- Actuarial services;
- Internal audit outsourcing services;
- Management functions or human resources;
- Broker or dealer, investment adviser, or investment banking services; or
- Legal services and expert services unrelated to the audit.

Sarbanes-Oxley gives the PCAOB, subject to the review of the SEC, the right on a case by case basis to exempt any person or public accounting firm, or any particular transaction, from the provisions of §201. The SEC's final rules provide that foreign accounting firms can provide tax services (permitted under Sarbanes-Oxley) despite their being considered legal services (prohibited under Sarbanes-Oxley) under home country law.

With respect to privately-held companies and not-for-profits, it is certainly in the organization's best interests that auditors are independent and do not have the conflict of interest which is potentially embedded if the audit firm performs other, non-audit-related, services for the company. However, it is also the case that for certain limited non-audit engagements, the outside audit firm can be almost uniquely capable of performing the function best and most efficiently, and provided that there is full disclosure of the situation to an approving audit committee, this seems to be one area of Sarbanes-Oxley where occasional exceptions to the general prohibition make sense.

Auditor Rotations, Conflicts, and Independence

Sarbanes-Oxley requires that the audit firm itself, following registration with the PCAOB, rotate its lead audit partner every five years (§ 203), and the possibility of firm-wide rotations was directed to be studied by the Comptroller General (§ 207).[11]

To implement the requirements of Sarbanes-Oxley, the SEC adopted amendments to its existing requirements regarding auditor independence. The SEC's rules have added the concurring partner to the required five-year rotation and also require both the lead and the concurring audit partners to then sit out for five years. "Audit partners,"[12] other than the lead and concurring partner, must rotate after no more than seven years and then must have a two-year time-out.[13]

The auditor rotation requirements received a number of comments from non-U.S. firms, but they apply nonetheless to foreign audit firms, with certain foreign-directed exceptions, including an exception for auditors of subsidiaries whose revenues constitute less than 20% of the consolidated assets or revenues of the parent.

With respect to private companies and not-for-profits, the law does not extend to rotation requirements, and in this area we expect that most companies will not comply strictly with the auditor rotation practice, provided that the audit committee can be otherwise assured that their company's financials are being given a fresh eye from other sources, such as perhaps periodic rotation of the outside and internal personnel assigned to various aspects of the audit.

The SEC's adopting release specified that, to calculate the rotation rules, the rotation requirement for the lead audit partner is effective for the company's first fiscal year ending after May 6, 2003 (with time served as lead partner prior to May 6, 2003 being included), and the rotation requirement for the concurring audit partner is effective for the company's second fiscal

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[11] The GAO Report on this issue, GAO-04-216, was published in November 2003 and concluded that further experience and study was required, and that the costs of mandatory firm rotation might well outweigh the benefits.

[12] "Audit partners" are those with responsibility for decision-making on significant auditing, accounting, and reporting matters that affect the financial statements or who maintain regular contact with management and the audit committee, other than a partner who consults regarding technical or industry-specific issues, transactions or events. "National office" and other "specialty" partners who may be consulted on specific accounting issues related to a client are not considered audit partners, even if they periodically consult on client matters.

[13] Any accounting firm with less than five audit clients that are covered issuers and less than ten partners is exempt from the partner rotation rule as long as the Oversight Board conducts a review at least once every three years of each audit client engagement that would result in a lack of independence.

year ending after May 6, 2003 (with time served as concurring audit partner prior to May 6, 2003 also being included).

For other "audit partners," the rotation rule is effective as of the beginning of the first fiscal year after May 6, 2003 (with service prior to May 6, 2003 not being counted, so that such first fiscal year after May 6, 2003 will be the first applicable year of service for these other audit partners). In its final rules, the SEC recognized that, in many foreign jurisdictions, partners were previously not subject to rotation requirements. Therefore, for all partners with foreign accounting firms who are subject to rotation requirements, the rules are effective as of the beginning of first fiscal year after May 6, 2003. In determining the time served, the first fiscal year will constitute the first year of service for such partners.

With respect to conflicts of interest, Sarbanes-Oxley (§ 206) specifies that an accounting firm cannot perform an audit for a registrant if a CEO, controller, CFO, chief accounting officer, or any person in an equivalent position for the company was employed by that audit firm and participated in any capacity in the audit of that company during the one-year period preceding the initiation of the audit. In addition, the SEC's final rules provide that an accounting firm will not be deemed independent in respect of a fiscal year, if a former member of the audit engagement team (who performs more than 10 hours of audit, review or attest services for the company) accepts employment with the client in a "financial reporting oversight" role without first observing a prescribed one-year cooling off period. The SEC's final rules are effective for employment relationships with the company that commence after May 6, 2003. Individuals who began employment prior to May 6, 2003, do not have to sever their employment relationship.

Here again we expect that private companies and non-profit organizations not subject to Sarbanes-Oxley will give due deference to this aspect of the new law and regulations, but that an otherwise qualified audit engagement team member might well be considered employable in a financial reporting oversight role, if the audit committee or management are otherwise reasonably satisfied that any independence issues can otherwise be dealt with effectively.

With respect to audit services (including review and attest services) and permitted non-audit services, effective May 6, 2003, the SEC's rules as to auditor independence (which apply equally to audits of foreign private issuers and to foreign audit firms) require prior approval by

either the full audit committee, otherwise the service must be performed pursuant to prior approval policies established by the audit committee, which must then be informed of each engagement. The audit committee's responsibilities may not be delegated to management. If the rules are not satisfied, the auditor is not deemed independent. In our judgment, this is good corporate practice, and should be followed by the audit committees and management of substantial private companies and non-profits alike.

The auditor pre-approval policies and audit-related fees billed during the prior two fiscal years must be disclosed in covered companies' annual reports and proxy statements commencing with their 2003 filings.

Communications with Audit Committees

Sarbanes-Oxley (§204) directed the SEC to establish rules requiring timely reporting of specific information by accountants to audit committees. In response to this directive, the SEC enacted rules which require each accountant performing any audit required under the securities laws to report to the audit committee, prior to the SEC filing of such audit report:

- all critical accounting policies and practices to be used;
- all alternative treatments within GAAP "for policies and practices related to material items" that have been discussed with management of the issuer, including the ramifications of the use of such alternative disclosures and treatments and the treatment preferred by the registered accounting firm; and
- other material written communications between the firm and the management of the company, such as any management letter or schedule of unadjusted differences.

This provision was effective May 6, 2003. Here again, we consider such timely and effective communication between the audit firm and the audit committee of substantial private companies and non-profits to be good corporate governance practice which should be adopted.

The Audit Committee Rules

Sarbanes-Oxley requires all listed companies to have audit committees comprised solely of independent, unaffiliated directors who do not accept any consulting, advisory, or other compensatory fee from the company (§ 301). That committee, with independent counsel and

advisors of its choice, with its own budget, is required to appoint, oversee, and compensate the auditors, and resolve financial reporting disagreements, and must establish complaint and whistle-blower procedures ensuring anonymity and confidentiality to informants.

If the company does not have an audit committee, then the full Board shall be deemed the committee. An anticipated problem, which has developed and intensified, is finding qualified individuals for the audit committee who do not also aspire to other relationships with the company beyond their committee and Board meetings. The universe of these persons is limited. It is therefore unlikely that private companies and non-profits will embrace the audit committee rules as stated literally; it is more probable that independent directors already on the Boards of such entities will have their available time directed first to audit committee service and then to other "independent" areas where executive directors are thought to be potentially offside.

On April 9, 2003, the SEC published Rule 10A-3 under the Securities Exchange Act of 1934, which prohibits the national securities exchanges and Nasdaq from listing any security of a company that does not have a wholly independent audit committee (subject to the transition rules below), with the specified rights and responsibilities. Rule 10A-3 requires companies to disclose the names of members of the audit committee in the company's annual report. If the company has not picked its own audit committee and has opted, by default, to have its entire board of directors constitute the audit committee, this too must be disclosed in its annual report.

The following discusses the principal requirements of the SEC's rules relating audit committees including: (i) how such rules apply to foreign private issuers; (ii) the audit committee's relationship with outside accountants; (iii) the audit committee member independence requirements; (iv) the audit committee's procedures for handling whistleblower accounting complaints; (v) the audit committee's right to hire independent counsel and outside advisors and (vi) the audit committee's financial expert.

Foreign Applicability Rule 10A-3 makes it clear that they apply also to foreign private issuers, with the specific adjustments discussed below in the case of real conflicts with the laws of certain foreign jurisdictions. Also as a gesture to foreign private issuers, the SEC has given them extra time to comply by delaying the implementation of Rule 10A-3 to July 31, 2005. U.S. public companies, however, must be in compliance with Rule 10A-3 by the date of their first

annual shareholder meeting after January 15, 2004 and, in any event, no later than October 31, 2004.

Relationship with the Outside Accountants Rule 10A-3 shifts the responsibility for the relationship with the outside accountants from the company's management to the audit committee. Now it is the audit committee that is responsible for appointing, compensating, overseeing and terminating the outside accountants.

Included in these new audit committee functions is the requirement that the audit committee resolve accounting disagreements between management and the outside accountants. The outside accountants must report directly to the audit committee which must investigate any differences of opinion they may have had with management over the contents of the financial statements, including critical accounting policies used, any elections made between alternative possible accounting treatments that would have different impacts on the bottom line, and any estimates or assumptions contained in the financials.

In the event of a difference of opinion between management and the outside accountants as to how the financial statements should be presented, the audit committee must become familiar with the issues and approve the final outcome on the merits.

The audit committee must also ensure that the outside accountants are not providing any prohibited non-audit services, such as internal audit services that might lead the outside accountants to monitor their own activities. The audit committee must pre-approve all permitted non-audit services that could, if not closely monitored, lead to the same self-policing result. The audit committee must monitor that significant members of the audit engagement team are rotated as required on a periodic basis, and that the company observes the mandated cooling-off period before employing a former employee of the outside accounting firm.

Rule 10A-3 notes that the audit committee's responsibility for oversight, appointment and termination of the independent accountant may conflict with certain foreign laws governing a foreign private issuer. For example, some foreign laws require shareholder approval or full Board approval for the appointment or removal of outside accountants or may require that an independent accountant be removed by court order. Rule 10A-3 addresses these situations by providing that shareholder, full Board or court approval for the appointment or removal of the

independent accountants pursuant to foreign law will not be in violation of Sarbanes-Oxley provided that the audit committee is given certain advisory powers which must be taken in to account when appointing or removing independent accountants.

As discussed above, it is simply good practice for the audit committees of private companies and non-profits, which should be at least heavily populated by directors independent of management, take the same functions with respect to the outside auditors as are required of public companies under Sarbanes-Oxley.

Audit Committee Member Independence Requirements Audit committee members cannot accept any consulting, advisory or other compensatory fees from the company, except in exchange for their service as independent Board members or members of the audit committee. This means that an audit committee member who is a partner or executive officer in a law firm, accounting firm, consulting firm, investment bank or similar entity, that receives fees for rendering professional advice to the company, would not be deemed independent. In addition, under Rule 10A-3, a director cannot be an affiliated person of the issuer or any subsidiary of the issuer.

With private companies and non-profits, strict compliance with these independence definitions is very difficult, especially since those persons with the closest contact with, and knowledge of, the organization typically have some other financial or professional relationship with the entity. "Independent" in these contexts therefore usually means independent from management, although that is often difficult as well, if outside professionals who report to and represent management on a daily basis are appointed to the Board and Committees to oversee the officers who appoint them and approve their compensation.

For independence purposes, Rule 10A-3 defines an affiliated person as one that controls, or is controlled by, or is under common control with the company, and defines control as the possession of the power to direct the management and policies of a company. The SEC noted that it might be difficult to determine whether an individual controls a company, and therefore proposed a safe harbor pursuant to which a person who is not an executive officer or 10% shareholder of any class of voting equity securities of the company would not be deemed to control the company.

Independence Exemptions While the new audit committee rules apply to U.S. issuers and to covered foreign private issuers alike, there are useful general exemptions and specific foreign private issuer exemptions.

First, the SEC recognized that companies coming to market for the first time may face particular difficulty in finding audit committee members that meet the independence requirements. Therefore Rule 10A-3 relaxed the independence requirements for such companies by requiring that the audit committee need include only one fully independent member at the time of the company's initial listing, as long as it has a majority of independent members within 90 days, and a fully independent committee within one year.

Second, Rule 10A-3 eased the independence requirements for audit committee members who have certain overlapping board relationships. Specifically, an audit committee member, who otherwise meets Sarbanes-Oxley's independence requirements, will not be disqualified merely because he or she sits both on the board of the company and one or more of its affiliates.

Third, Rule 10A-3 recognized that the laws of certain countries, such as Germany, require non-management employees, who would not be viewed as independent under Sarbanes-Oxley, to serve on the audit committee. Accordingly, Rule 10A-3 provides that non-executive employees may sit on the audit committee of such companies if their presence is required pursuant to home country laws, or an employee collective bargaining agreement, or other home country legal or listing requirements.

Fourth, Rule 10A-3 recognizes that non-affiliation component of the definition of independence might interfere with the prevailing custom of certain non-U.S. public companies to appoint controlling shareholders to their audit committees, including foreign government representatives with significant shareholdings. Therefore, Rule 10A-3 provides an exception pursuant to which a controlling shareholder of a non-U.S. public company will not be disqualified from being a member of the audit committee if: (i) he or she receives no compensation, other than Board compensation, (ii) in the case of a controlling shareholder that is not a government representative, he or she only has observer status on, and is not a voting member or the chair of the audit committee, and (iii) he or she is not an executive officer of the company.

In addition, the SEC recognized that foreign governments may have significant shareholdings in some foreign private issuers or may own special shares that entitle the government to exercise certain rights relating to these issuers. Therefore, under Rule 10A-3, any audit committee member can be a representative of a foreign government or foreign governmental entity, if the member receives no compensation other than Board compensation and the member is not an executive officer of the company.

Finally, Rule 10A-3 recognizes that several non-U.S public companies are required by home country law to establish committees not necessarily called "audit committees," but nevertheless serving equivalent functions. In these situations, the establishment of an audit committee under Sarbanes-Oxley in addition to the equivalent committee would result in duplicative functions and costs. Accordingly, the SEC has exempted such non-U.S. public companies from certain of the audit committee requirements, provided such board auditors or equivalent committee has a degree of independence from the board of directors and management, fulfill outside accountant oversight responsibilities, have procedures for handling whistleblower accounting complaints, and have access to outside advisors.

Generally, companies relying on an exemption must disclose such reliance in their public filings and make an assessment of whether and the extent to which such reliance might compromise the independence of their audit committee. However, no disclosure is required if the company relies on the exemption relating to overlapping board relationships.

Procedures for Handling Whistleblower Accounting Complaints Rule 10A-3 requires the audit committee to establish procedures for: (i) the receipt, retention, and treatment of complaints received by the company regarding accounting, internal accounting controls or auditing matters, and (ii) the confidential, anonymous submission by employees of the company of concerns regarding questionable accounting or auditing matters.

Rule 10A-3 does not mandate specific procedures that the audit committee must establish in order to implement this requirement. Rather, the SEC recommended that each audit committee develop procedures that work best for each company's individual circumstances. In this connection, many companies have established hot lines on which employees can leave

anonymous messages, and this is an excellent recommended practice for private companies and non-profits as well.

The Right to Hire Independent Counsel and Outside Advisors Under Sarbanes-Oxley and Rule 10A-3, a company's audit committee must have the independent authority to engage independent counsel and other advisors, paid for by the company.

In addition, Sarbanes-Oxley requires the company to provide the audit committee with sufficient funding to compensate any advisors it employs. Further, Rule 10A-3 provides that, in addition to providing funding for advisors, companies must provide appropriate funding for the ordinary administrative expenses of the audit committee.

In the case of private companies, it is unrealistic to expect the audit committee to have these independent rights; in the case of substantial non-profits, it might well be reasonable to enable the audit committee to comply with these Sarbanes-Oxley requirements, especially in view of the importance accorded to these rights in the new law.

Audit Committee Financial Expert Sarbanes-Oxley (§407) directed the SEC to enact rules requiring companies to disclose whether the audit committee of a company has at least one member with financial expertise. On January 23, 2003, the SEC enacted rules which require covered companies to disclose in their annual reports for fiscal years ending on or after July 15, 2003 (December 15, 2003 for small business issuers) whether their audit committee has at least one member who is an "audit committee financial expert," and, if so, the name of the expert and whether the expert is independent of management.[14] And if the audit committee has no financial expert, the company must explain why not.

In order to qualify as an "audit committee financial expert," the person must have all of the following five attributes:

- An understanding of GAAP and financial statements;

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[14] The SEC's rules include a safe harbor to clarify that the audit committee financial expert has no higher degree of responsibility compared to other audit committee members or members of the Board. Under the SEC's rules a person deemed an audit committee financial expert will not be considered an "expert" for any purpose, including without limitation for purposes of Section 11 of the Securities Act of 1933, which gives investors the right to sue in connection with misleading statements or omissions. In addition, the SEC's rules provide that the designation of an audit committee financial expert does not affect the duties, obligations or liability of any other member of the audit committee or Board of Directors.

- The ability to assess the general application of GAAP in connection with the accounting for estimates, accruals and reserves;
- Experience preparing, auditing, analyzing or evaluating financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of issues that can reasonably be expected to be raised by the company's financial statements, or experience actively supervising one or more persons engaged in such activities;
- An understanding of internal controls and procedures for financial reporting; and
- An understanding of audit committee functions.

The final rules require a person to have acquired these attributes through any one or more of the following:

- Education and experience as a principal financial officer, principal accounting officer, controller, public accountant, or auditor, or experience that involves the performance of similar functions;
- Experience actively supervising a principal financial officer, principal accounting officer, controller, public accountant, auditor or person performing similar functions;
- Experience overseeing or assessing the performance of companies or public accountants with respect to the preparation, auditing or evaluation of financial statements; or
- Other relevant experience.

In the case of foreign private issuers, SEC's rules specify that the financial expert's understanding must be of GAAP as employed by the foreign private issuer in preparing its primary financial statements filed with the SEC.

Foreign private issuers will be required to disclose whether their financial experts are independent of management by July 31, 2005. Under the audit committee financial expert disclosure provisions, the term "audit committee" for certain foreign private issuers, which have a board of auditors (or similar body) or have statutory auditors established pursuant to home

country requirements, generally means the board of auditors or similar body of statutory auditors.

As noted above, companies are not obliged to actually have financial experts on the Board but are only required to disclose if they do and if not, why not. A non-U.S. public company could comply with the requirements of Sarbanes-Oxley by stating that it does not have a financial expert because there is no requirement under the law of its home jurisdiction to have one. In the case of private companies and non-profits, it would certainly be positive if one of the independent directors assigned to the audit committee satisfied these requirements.

One solution that has been recommended for a company that cannot find an audit committee member with the required qualifications is to retain a financial expert as an outside consultant. This solution would be consistent with § 301 of Sarbanes-Oxley which authorizes audit committees to engage outside advisors.

Nominating Committees and Communications between Security Holders and Boards

On November 24, 2003, the SEC adopted new disclosure requirements regarding: (i) the operations of Board nominating committees and (ii) the means, if any, by which security holders may communicate with directors. In general, these rules require disclosure but do not mandate any particular action by a company or its Board of Directors. Foreign private issuers are generally not affected by these disclosure requirements because they are not subject to the proxy rules. Private companies typically choose their directors in close coordination with the controlling shareholders, and substantial non-profits typically have nominating committees which would satisfy the substance of these requirements of Sarbanes-Oxley.

With respect to the new disclosure regarding nominating committees, these rules expand the current proxy statement disclosure to include:

- a statement as to whether the company has a nominating committee or committee performing similar functions and, if not, an explanation as to why the Board has decided not to have a nominating committee, and identification of each director who considers director nominees;

- certain information regarding the company's director nomination process, including whether the nominating committee's charter is available on the company's website or other information disclosing where this charter has been disclosed;
- if the nominating committee does not have a charter, a statement indicating such fact;
- if the company is a listed issuer, disclosure as to whether the members of the nominating committee are independent as independence is defined in the listing standards applicable to the listed issuer;
- if the company is not a listed issuer, disclosure as to whether each of the members of the nominating committee is independent by using one of the self regulatory organizations' definition of independence;
- if the nominating committee has a policy with regard to the consideration of any director candidates recommended by security holders, a description of the material elements of that policy including whether the committee will consider director candidates recommended by security holders;
- if the nominating committee does not have a policy with regard to consideration of any director candidates recommended by security holders, a statement of that fact and the basis for the Board's view that it is appropriate for the company not to have such a policy;
- if the nominating committee will consider candidates recommended by security holders, a description of the procedures to be followed by security holders in submitting such recommendations;
- a description of any specific, minimum qualifications that the nominating committee believes must be met by a nominating committee-recommended nominee and a description of any specific qualities or skills that the nominating committee believes are necessary for one or more of the company's directors to possess;
- a description of the nominating committee's process for identifying and evaluating nominees for director, including nominees recommended by security holders, and any

differences in the manner in which the nominating committee evaluates nominees for director based on whether the nominee is recommended by a security holder;

- with regard to each nominee approved by the nominating committee for inclusion on the company's proxy card (other than nominees who are executive officers or who are directors standing for re-election), a statement as to which one or more of the following categories of persons or entities recommended that nominee: security holder, non-management director, CEO, other executive officer, third-party search firm, or other specified source;

- if the company pays fees to any third party to identify or evaluate or assist in identifying or evaluating potential nominees, disclosure of the function performed by such third party;

- if the company's nominating committee received, by a date not later than the 120th calendar day before the date of the company's proxy statement released to security holders in connection with the previous year's annual meeting, a recommended nominee from a security holder (or group of security holders) that beneficially owned more than 5% of the company's voting common stock, identification of the candidate and the security holder (or security holder group) and disclosure as to whether the nominating committee chose to nominate the candidate; provided however, that no such disclosure is required without the written consent of both the security holder (or security holder group) and the candidate.

In addition, the SEC adopted new disclosure standards relating to security holder communications with Board members. Companies are required to provide the following disclosure:

- a statement as to whether the company's Board provides a process for security holders to send communications to the Board; if not, an explanation as to why there is no process;

- if the company has a process for security holders to send communications to the Board, (i) a description of the manner in which security holders can send communications to the Board and, if applicable, to individual directors; and (ii) if all security holder

communications are not sent directly to Board members, a description of the company's process for determining which communications will be relayed to the Board members; and

- a description of the company's policy, if any, with regard to Board members' attendance at annual meetings and a statement of the number of Board members who attended the prior year's annual meeting.

In addition, the new disclosure requirements require companies to disclose their policy with regard to director attendance at annual meetings and the number of directors who attend annual meetings. The SEC clarified that communications from an officer or director of the company will not be viewed as security holder communications for purposes of the disclosure requirement, but the SEC noted that communications from an employee or agent of the company will be viewed as security holder communications only if those communications are made solely in such employee's or agent's capacity as a security holder. In addition, the SEC excluded security holder proposals pursuant to Exchange Act Rule 14a-8 from the definition of "security holder communications." Also, the SEC adopted new disclosure standards that require companies to report any material changes to the procedures for security holder nominations in the Exchange Act Forms 10-Q, 10-QSB, 10-K, or 10-KSB filed for the period in which the material change occurs.

Companies must comply with these disclosure requirements in proxy or information statements that are first sent or given to security holders on or after January 1, 2004, and in Forms 10-Q, 10-QSB, 10-K, 10-KSB, and N-CSR for the first reporting period ending after January 1, 2004.

Security Holder Director Nominations

The SEC has proposed rules that would, under certain circumstances, require companies to include in their proxy materials security holder nominees for election as a director. Security holders would not have the right to nominate directors where it is prohibited by state law. The proposed rules aim to create a mechanism for nominees of long-term security holders, or groups of long term security holders, with significant holdings to be included in company proxy materials where there are indications that security holders need access to create an effective

proxy process. Under the proposed rules, the mechanism would apply when a company has been unresponsive security holder concerns relating to the proxy process. The proposed rules would allow security holders to engage in limited solicitations to form nominating security holder groups and engage in solicitations in support of their nominees without disseminating a proxy statement. Under these rules, nominating security holders would be subject to filing requirements under the Exchange Act.

These proposals would be largely inapplicable in substance to the operations of private companies or non-profits. Foreign private issuers are generally not subject to the proxy rules and would generally not be affected by these proposed requirements.

Code Of Ethics For Principal Officers Under Sarbanes-Oxley

Section 406 of Sarbanes-Oxley and the SEC's rules thereunder require reporting companies to disclose whether or not they have adopted a code of ethics for their principal executive officers, senior financial officers, principal accounting officers or principal financial officers or controllers, or persons performing similar functions. A company which has not adopted such a code of ethics must explain why it has not done so.

A code of ethics, under the SEC's rules, is defined to mean such standards as are reasonably necessary to promote:

- honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships;
- full, fair, accurate, timely and understandable disclosure in the periodic reports required to be filed and in other public communications made by the company;
- compliance with applicable governmental rules and regulations;
- the prompt internal reporting to an appropriate person or persons identified in the code of violations of the code; and
- accountability for adherence to the code.

The SEC's rules allow companies to choose between three alternative methods of making their ethics codes publicly available.

First, a company may file a copy of its code of ethics as an exhibit to its annual report (on Forms 10-K, 10-KSB, 20-F or 40-F).

Alternatively, a company may choose to post the text of the code on its website, provided that the company also discloses its internet address as well as its intention to provide disclosure in this manner in its annual report.

Finally, a company may provide an undertaking in its annual report to provide a copy of its code of ethics to any person without charge upon request.

In addition, Sarbanes-Oxley (§ 406(b)) directs the SEC to require a company to make immediate disclosure on Form 8-K or via internet dissemination of any change to, or waiver from, the company's code of ethics for its senior financial officers. The SEC's implementing rules add an item to the list of the Form 8-K triggering events to require disclosure of: (i) the nature of any amendment of a code of ethics applying to the company's principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions and (ii) the nature of any waiver (including an implicit waiver) of a provision of the company's code of ethics granted to the specified officers, the name of the person to whom the company granted the waiver and the date of the waiver.

A company choosing to provide the required disclosure on Form 8-K must do so within five business days after it amends its ethics code or grants a waiver. As an alternative to reporting this information on Form 8-K, a company may use its website as a method of disseminating this disclosure, but only if it previously has disclosed in its most recently filed annual report on Form 10-K or 10-KSB: (i) its intention to disclose these events on the website, and (ii) its website address.

A foreign private issuer is required to provide the new code of ethics disclosure in its Exchange Act annual report. A covered foreign private issuer, however, will not have to provide in a current report "immediate disclosure" of any change to, or waiver from, the company's code of ethics for its senior financial officers and principal executive officers. Instead, foreign private issuers are required to disclose any such change or waiver that has occurred during the past fiscal year in their Exchange Act annual reports. The SEC indicated that foreign private issuers may

choose to disclose any change or waiver from the code of ethics obligations of their senior officers on a Form 6-K or on their website.

Companies were required to comply with the code of ethics disclosure requirements promulgated under Section 406 of Sarbanes-Oxley in their annual reports for fiscal years ending on or after July 15, 2003. In addition, companies must comply with the requirements regarding disclosure of amendments to, and waivers from, their ethics codes on or after the date on which they file their first annual report in which disclosure of the code of ethics is required.

Codes of Ethics are good business practice, and should be implemented as such by substantial private companies and significant not-for-profit corporations as well.

CEO and CFO Financial Certifications

Sarbanes-Oxley created two distinct certification requirements applicable to the CEOs and CFOs of covered companies, one, § 302, effective 30 days after the law's enactment, and the other, § 906, effective immediately upon the law's enactment. [15]

The Original Section 302 Certification Section 302 of Sarbanes-Oxley and the SEC's implementing rules originally required the CEO and the CFO principal executive officer and principal financial officer to make specific certifications, following the signature page of the filing, in each annual report on Forms 10-K, 10-KSB, 20-F and 40-F. These certifications did not, and as amended do not apply to current reports submitted on Forms 8-K and 6-K, even those including financial statements. The certification requirement also applies to quarterly reports on Forms 10-Q and 10-QSB. The certification requirement applies to amendments to, and transition reports on, any of the applicable reports.

Prior to the rule changes discussed below, the § 302 certification included in each annual report on Forms 10-K, 10-KSB, 20-F and 40-F (which before and after the changes must be in the exact form specified in the relevant report) consisted of a statement of the certifying officer that:

1. he or she has reviewed the report being filed;

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[15] The certification requirements of Sarbanes-Oxley are much broader than the SEC's June 27, 2002 certification order (No. 4-460) (the "Order"), which applied to almost 1,000 of the country's largest companies.

2. based on his or her knowledge, the report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by the report;
3. based on his or her knowledge, the financial statements, and other financial information included in the report, fairly present in all material respects the financial condition, results of operations and cash flows of the issuer as of, and for, the periods presented in the report;
4. he or she and the other certifying officers are responsible for establishing and maintaining disclosure controls and procedures for the issuer and have:

   (i) designed such disclosure controls and procedures to ensure that material information relating to the issuer, including its consolidated subsidiaries, is made known to them by others within those entities, particularly during the period in which the periodic reports are being prepared; (ii) evaluated the effectiveness of the issuer's disclosure controls and procedures as of a date within 90 days prior to the filing date of the report (the evaluation date)[16]; and (iii) presented in the report their conclusions about the effectiveness of the disclosure controls and procedures based on their evaluation as of the evaluation date;
5. he or she and the other certifying officers have disclosed, based on their most recent evaluation, to the issuer's auditors and the audit committee of the issuer's Board of Directors (or persons fulfilling the equivalent function): (i) all significant deficiencies in the design or operation of internal controls which could adversely affect the issuer's ability to record, process, summarize and report financial data and have identified for the issuer's auditors any material weaknesses in internal controls; and (ii) any fraud, whether or not material, that involves management or other employees who have a significant role in the issuer's internal controls; and
6. he or she and the other certifying officers 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 most recent

[16] As discussed below, the SEC adopted amendments to the §302 certification requiring the evaluation to be as of the end of the period covered by the report, rather than 90 days after the filing date.

evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

The Revised Section 302 Certification The SEC adopted rules on June 5, 2003 (the "June 5th Rules"), which among other changes, revised the language required to be inserted in the Section 302 certification.

The following amendments are effective for Section 302 certifications included with reports due on or after August 14, 2003. These amendments include: (i) the clarification that "Disclosure Controls and Procedures" may be designed under the supervision of the principal executive and financial officers; (ii) a revision to the effect that officers must evaluate the effectiveness of the disclosure controls "as of the end of the period covered by the report" rather than "as of a date within 90 days prior to the filing date" of the report as required by the old Section 302 certification, although the revised certification is silent as to the date on which the evaluation must be conducted; (iii) a new paragraph replaces paragraph 6 requiring a certification regarding changes in the company's Internal Control Over Financial Reporting that occurred during the company's most recent fiscal quarter; and (iv) a few other revisions.

The following amendments are effective for Section 302 certifications upon the effectiveness of the SEC's rules regarding Internal Control Over Financial Reporting (discussed below). First, in paragraph 4, the certifying officers must include a statement that he or she is responsible for establishing and maintaining the Internal Control Over Financial Reporting. Second, the revised amendments add a new paragraph in which the certifying officers confirm that they have designed such Internal Control Over Financial Reporting, or caused such Internal Control Over Financial Reporting to be designed under their supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP.

Aside from these modifications, the Section 302 certification will, as before, continue to require a CEO and CFO of a public company to certify in the periodic reports that (i) the company's periodic reports are not misleading within the meaning of Rule 10b-5 of the Securities Exchange Act of 1934 (the "Exchange Act") (ii) that the financial information included in such reports fairly present in all material respects, the financial condition of the

company and that (iii) appropriate "Disclosure Controls and Procedures" have been put in place to ensure the quality and timeliness of the information contained in the report. The words "fairly present" requires more than mere compliance with GAAP. They require disclosure of overall material accuracy and completeness.

The Section 302 certification language may not be altered, must be signed by both the CEO and CFO or persons with equivalent functions on separate certificates, and cannot be made by power of attorney.

In addition to the Section 302 certification, the CEO and the CFO will be required, as before, to give the separate Section 906 certification.

One of the revisions introduced by the June 5th Final Rules relates to the location of the Section 302 certifications. Beginning August 14, 2003, the Section 302 certifications will be required to be "filed" as exhibits to the periodic reports to which they relate rather than included in the reports following the signature page as was the case prior to the June 5th Final Rules. Because the Section 302 Certification is required to be "filed," rather than "furnished," it will subject the company to liability for misleading statements under Section 18 of the Exchange Act and it will it be automatically incorporated by reference into a company's registration statements under the Securities Act of 1933, as amended.

With respect to private companies and not-for-profit corporations, the formal certifications required of the CEO and CFO by Sarbanes-Oxley obviously are not essential, but clearly the trend in good practice is for more and more specific involvement by the senior management in the underlying financial procedures and their application and results. It will depend on the facts of each organization whether the formality of these certifications is required in some analogous fashion. Further, the Office of the New York State Attorney General Eliot Spitzer, has published a booklet entitled "Internal Controls and Financial Accountability for Not-For-Profit Boards" available at http://www.oag.state.ny.us/charities/charities.html, which provides general information and guidance concerning internal controls for the protection and oversight of charitable assets.

Penalties Officers who provide a false Section 302 certification potentially could be subject to SEC action for violating Section 13(a) or 15(d) of the Exchange Act, and to both SEC

and private action for violating Section 10(b) of the Exchange Act and Exchange Act Rule l0b-5. The SEC adopting release regarding Section 302 also states that a false Section 302 certification could give rise to liability consequences under Sections 11 and 12(a)(2) of the Securities Act in cases where a quarterly or annual report is incorporated by reference into a registration statement on Form S-3 or into a prospectus filed pursuant to Securities Act Rule 424(b).

The Original Section 906 Certification Section 906 of Sarbanes-Oxley requires the CEO and CFO of each issuer to certify that each periodic report filed by an issuer: (a) fully complies with the requirements of §13(a) or 15(d) of the Securities Exchange Act of 1934 and (b) that the information contained in the periodic report fairly presents, in all material respects, the financial condition and results of operations of the issuer.

The § 906 certification requirement of Sarbanes-Oxley is a criminal provision, with fines for "knowing" violations of up to $1 million and imprisonment up to 10 years, and with "willful" violations attracting a fine up to $5 million and imprisonment up to 20 years. Sarbanes-Oxley is silent regarding the ramifications of failing to file the Section 906 certification or filing one that does not comply with the Act, although the SEC has indicated that it believes that an action for failure to file can be brought under Section 32 of the Exchange Act.

For foreign private issuers, CEOs and CFOs must certify under § 906 (as an exhibit to the filing) each annual report on Form 20-F or 40-F.

Unlike Section 302, the Section 906 certification is absolute, with no "knowledge" or "materiality" qualifier, but the criminal penalties are reserved for those who certify "knowing" that the report in question does not comport with the requirements.

In summary, with respect to foreign private issuers, annual reports on Forms 20-F and 40-F must include the Section 302 and Section 906 certifications, and the company's disclosure controls and procedures are expected to ensure the full and timely disclosure in current reports submitted on Form 6-K (including earnings releases). Therefore, foreign private issuers need to design, maintain and enforce the required disclosure controls and procedures, as well as review their existing internal controls, to ensure full and timely disclosure on an ongoing basis.

Thus, U.S. public companies and foreign private issuers have been subject to the disclosure controls and procedures and the internal accounting controls certification requirements

of Section 302 of Sarbanes-Oxley since August 29, 2002, when the SEC published its final rules. U.S. public companies and foreign private issuers have also been subject to the certification requirements of Section 906 of Sarbanes-Oxley since July 30, 2002, the effective date of Sarbanes-Oxley.

The Required Section 906 Certification Language Under the June 5th Rules The Section 906 certification language was not amended by the June 5th Rules. However, as of the first compliance date, it must be "furnished" as an exhibit to the periodic report containing financial statements to which it relates rather than included in the report following the signature page as was the case prior to the June 5th Rules. Because the Section 906 certification is "furnished" rather than "filed," it will not subject the signers to liability under Section 18 of the Exchange Act for misleading statements nor will it be automatically incorporated by reference into a company's registration statements under the Securities Act. The CEO and the CFO may sign a single Section 906 certification.

Practical Differences Between the Section 302 Certification and the Section 906 Certification Requirements Unlike the Section 302 certification, the Section 906 certification is required in periodic reports that contain financial statements. Therefore, amendments to periodic reports that do not contain financial statements would not require a new Section 906 certification but would require a new Section 302 certification to be filed with the Amendment. Moreover, unlike the Section 302 certification which requires a separate certification for each of the Chief Executive Officer and the Chief Financial Officer, the Section 906 certification may take the form of a single statement signed by the Chief Executive and the Chief Financial Officer.

The Section 906 Certification Requirements' Application to Current Reports on Forms 8-K and 6-K In the SEC's proposing release relating to certification amendments, the SEC stated that the Section 906 certification does not apply to Forms 8-K and 6-K because these reports are not periodic reports. However, in the June 5th Rules, the SEC noted the statement regarding Section 906 certifications introduced by Senator Joseph Biden into the Congressional Record on April 11, 2003 which takes the position that Section 906 was intended to apply to any financial statement filed by a public company, not only to reports on Forms 10-K and 10-Q, but

also financial statements in current reports on Forms 6-K and Form 8-K (in connection with significant acquisitions) and annual reports of certain benefit plans on Forms 11-K.

The SEC stated that it was concerned about subjecting reports on Forms 8-K, 6-K and 11-K to the Section 906 certification requirements and was considering the issue together with the Justice Department. In October 2003, it was reported that at the Association of Corporate Counsel conference, the Associate Director (Legal) of the Division of Corporation Finance announced that the SEC and the Department of Justice had concluded that § 906 certification does not apply to SEC Forms 8-K, 6-K and 11-K.

Disclosure Controls and Procedures

In August 2002, in addition to mandating the Section 302 certification, the SEC adopted rules, which require companies to maintain and companies' management, with the participation of the CEO and the CFO, to regularly evaluate the effectiveness of "disclosure controls and procedures" ("Disclosure Controls and Procedures"). Disclosure Controls and Procedures are generally controls and other procedures designed to ensure that the information required in a company's filings is recorded, processed, summarized and reported on a timely basis.

The SEC rules require companies to disclose the conclusions of the CEO and CFO, or persons performing similar functions, regarding the effectiveness of the registrant's disclosure controls and procedures. While the August 29, 2002 rules required officers to evaluate the effectiveness of the company's disclosure controls "as of a date within 90 days prior to the filing date" of the report, the June 5, 2003 Rules require that the officers must evaluate the effectiveness of the disclosure controls "as of the end of the period covered by the report."

The conclusions of the CEO and CFO concerning their evaluations of the Disclosure Controls and Procedures must be disclosed in the periodic reports. For this purpose, a new Item entitled "Controls and Procedures," has been added to quarterly reports and annual reports. Foreign private issuers must provide this disclosure under Item 15 "Disclosure Controls and Procedures" on Form 20-F, and Form 40-F also requires this disclosure under General Instruction B(6)(b).

Implementation of Disclosure Controls and Procedures All companies, to a greater or lesser extent, already have procedures in place for gathering and evaluating information to be included in their Exchange Act filings. The new SEC rules require companies to review their procedures, correct any deficiencies, and enhance them, as appropriate.

In contemplating the implementation of these procedures, companies should focus on the purpose and substance of the Disclosure and Control Procedures rather than on their form. The Procedures should be crafted in such a way that they are easy to follow and practical to implement. They should be in writing and should be customized to reflect the operations of the company and its particular risk profile. What follows is a list of suggestions, some recommended by the SEC and others that we believe are good practice, for the implementation of Internal Controls and Procedures designed to give the certifying officers the comfort level they need to sign the certifications and to provide the necessary disclosures.

Disclosure Committees Companies should consider establishing a disclosure committee charged with assisting the CEO and CFO in developing, writing and overseeing Disclosure Controls and Procedures. The disclosure committee should be made up of the general counsel, the principal accounting officer, the chief investor relations officer, the principal risk manager or persons with different titles but with similar responsibilities, heads of major business units and the head of the human resources department. The disclosure committee should identify persons both inside and outside the company whose input is critical to the disclosure process and set deadlines for the time they have to gather, verify and report the information to those preparing the disclosure.

Inventory of Current Procedures A logical starting point for the disclosure committee in developing Disclosure Controls and Procedures is to take an inventory of the company's existing practices and weaknesses with regard to:

- preparing annual reports on Forms 10-K, 10-KSB, 20-F or 40-F, quarterly reports on Form 10-Q, 10-QSB, current reports on Form 8-K, foreign issuer reports on Form 6-K, proxy and information statements, earnings press releases, rating agency reports, schedules 13D and 13G, reports on Forms 3, 4 and 5 to the extent that the company prepares them for their executive officers and directors, and website disclosure;

- the handling of whistle blower complaints;
- the review of any matters raised by the company's independent auditors in their management letter or in connection with any information included in the reports; and
- the retention of documents.

Controls and Procedures Timetable and Check List The disclosure committee should disseminate internally a Controls and Procedures check list which fills in any gaps and fixes any weaknesses discovered by the inventory. The check list should state that it has been adopted as part of the Disclosure Controls and Procedures required by Sarbanes-Oxley. The check list should be prepared in consultation with the company's internal and independent auditors and outside counsel with a view to blending, as far as possible, the Disclosure Controls and Procedures with the company's Internal Control Over Financial Reporting.

The check list should assign responsibility to designated individuals with deadlines for:

- gathering the documentation and information needed by each section of the relevant report under the relevant SEC rules and regulations, (i.e. Regulation S-X, S-K etc.);
- providing responses to any follow up questions arising out of the collected information;
- assessing risks the company may be facing in its business or in its operational, technology, or financial areas;
- taking a closer look at areas of disclosure that have raised questions in the past and for reviewing other hot button issues such as related party and off balance sheet transactions, revenue recognition policies, reserves or asset impairment;
- reviewing any alternative accounting treatments and why the company chose the one it did and whether it provides a fair presentation of the company's financial condition;
- communicating and meeting with the outside auditors and outside counsel in connection with their audit or review of the reports;
- reviewing any employee complaints regarding disclosure and bringing them to the attention of the audit committee;

- convening due diligence meetings with the participation of the disclosure committee and outside advisors to discuss the comprehensiveness of the material gathered and any disclosure issues;
- convening management meetings to evaluate any management letters received by the company from their independent accountants and to consider the adequacy of operating and information technology systems;
- preparation and revision of draft reports and the conducting of compliance checks of the pertinent SEC, exchange and Nasdaq regulations;
- gathering of back-up certifications for the Sections 302 and 906 certifications if the company decides to implement back-up certifications ;
- convening meetings with the CFO and CEO, the Board and the audit committee at which the reports can be carefully reviewed and any disclosure issues discussed; and
- signing off on drafts and final versions of the reports.

Back-up Certifications Companies may wish to consider obtaining "back-up" support certifications from certain officers that confirm the certifications of the CEO and CFO. Back-up certification may not be appropriate for all companies. One consideration, among others, is whether asking for back-up certificates will cascade down through the company and create an unmanageable bureaucratic structure.

Evaluation of Disclosure Controls and Procedures The disclosure committee should review and evaluate the check list at least quarterly in the case of U.S. companies and annually in the case of non-U.S. companies for the following:

- staffing inadequacies in the disclosure process;
- the level of experience of those drafting the reports;
- the reliability of the information systems used;
- whether those preparing the reports have access to the persons that have the information required and whether such persons are responsive to requests for information;

- whether sufficient time was allowed for review, comment and Q&A on drafts; whether transaction files were complete or were missing documents;
- whether material transactions and issues were included in early drafts and how long did it take for issues to surface;
- whether disclosures were accurate; whether form checks revealed any problems and if so whether they were corrected;
- whether there are adequate controls over related party transactions; and
- whether there was sufficient time to discuss issues and maintain a sufficient dialogue between the gatekeepers of the information. The results of this periodic evaluation should be discussed with the CEO, CFO, the Board of Directors and the audit committee.

Other Functions of the Disclosure Committee Other functions of the disclosure committee would include overseeing and coordinating the collection of information, resolving questions about the materiality of a development, reviewing and advising on the content of disclosure, drafting of disclosure and communication with the investing public, and recommending to the Board, the audit committee, the CFO and the CEO, the filing of the report.

Training Sessions For Controls and Procedures Periodic staff education programs should be held to ensure that employees in the organization are aware of the company's reporting obligations and what must be reported to management. Companies should consider whether they should offer training sessions customized for specific departments. Such sessions should be used as an opportunity to drive home the message that the Controls and Procedures come from the top and that integrity of disclosure is a question of company survival.

Using Technology to Capture All Potential, Relevant Information Consider adding software to rationalize the information gathering process including extranet systems, if not in place, that allow people at different locations to conference, review and make collectively agreed upon changes to documents in real time.

CEO and CFO Investigations Before Signing the Certifications Assuming that the steps described above in connection with the implementation of the Controls and Procedures

have been taken, the CEO and CFO should consider the following issues before signing the certification.

- The extent of their participation in the design, maintenance and evaluation of the company's Controls and Procedures.
- Their efforts to advise others of the seriousness of compliance.
- The overall accuracy of the relevant report's portrayals.
- The adequacy of explanations for questions regarding the report.
- The overall and specific adequacy of the Controls and Procedures to ensure timely and effective disclosure.
- The adequacy of the schedule and time periods for review.
- The adequacy of the evaluation of the Controls and Procedures in the relevant report.
- The up-the-ladder persons involved and their level of comfort.
- The particular emphasis on topics most likely to raise SEC issues.
- The familiarity and comfort of external and internal auditors with the report.
- The existence and resolution of any disagreements with auditors.
- The overall aggressiveness of the accounting.
- The audit committee's involvement with the process and the certifications.
- The records kept of the process.

Periodic Report Certification Requirements and the Controls and Procedures' Applicability to Foreign Private Issuers and to Current Reports on Form 8-K, Proxy Materials and Information Statements The certification regarding Controls and Procedures applies to annual reports filed by foreign private issuers on Forms 20-F and 40-F. Although the certification is not required for reports of foreign private issuers on Form 6-K, the Disclosure Controls and Procedures for generating a 6-K, especially those incorporating financial data, must be in place. These Controls and Procedures should be designed to ensure timely filing of Form

6-K reports via EDGAR (required since November 4, 2002) and to ensure that all information included in a Form 6-K is complete and accurate in all material respects.

Current reports such as reports on Forms 8-K, 6-K, proxy materials and information statements are not covered by the Section 302 certification requirement. Disclosure Controls and Procedures for these reports however, are required to be designed, maintained and evaluated to ensure full and timely disclosure even though there is no certification requirement. In this connection, companies should build in to their Disclosure Controls and Procedures, the mechanisms necessary to allow them to comply with the new Form 8-K filing deadlines (discussed below).

Section 404

Section 404(a) of Sarbanes-Oxley required the SEC to prescribe rules obliging each annual report of every covered company to contain (i) an internal control report stating that it is the responsibility of management to establish and maintain an adequate internal control structure and procedures for financial reporting and (ii) an assessment, as of the end of the most recent fiscal year of the company, of the effectiveness of these internal control structures and procedures.

Section 404(b) of Sarbanes-Oxley required the public accounting firm that issues an audit report on the company's annual financial statements to attest to, and report on, the assessment made by management. On March 9, 2004, the PCAOB issued Auditing Standard No. 2, which provides such standards, and the SEC approved Auditing Standard No. 2 on June 17, 2004.

The SEC adopted the June 5th Rules, which implement the requirements of §404(a) of Sarbanes-Oxley and amend the §302 certification requirements.

The June 5th Rules require annual reports to include an internal control report of management that contains: (i) a statement of management's responsibility for establishing and maintaining adequate "Internal Control Over Financial Reporting"[17] for the company; (ii) a

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[17] The June 5th rules define "Internal Control Over Financial Reporting" as: "A process designed by, or under the supervision of, the registrant's principal executive and principal financial officers, or persons performing similar functions, and effected by the registrant's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures

statement identifying the framework used by management to evaluate internal controls; (iii) management's assessment of the effectiveness of the company's Internal Control Over Financial Reporting as of the end of the company's most recent fiscal year, including a statement as to whether or not the company's Internal Control Over Financial Reporting is effective; and (iv) a statement that the registered public accounting firm that audited the company's financial statements has issued an attestation report on management's assessment. They also require management to evaluate, on a quarterly basis, material changes in the company's Internal Control Over Financial Reporting. The SEC has published Frequently Asked Questions regarding management's report on Internal Control Over Financial Reporting, available at http://www.sec.gov/info/accountants/controlfaq1004.htm.

Differences between Internal Control over Financial Reporting and Disclosure Controls and Procedures. The similarity of the two phrases -- "*Disclosure Controls and Procedures*" versus "*Internal Control Over Financial Reporting*" has resulted in confusion.

"Disclosure Controls And Procedures" are meant to ensure, as far as possible, that all the information required by law to be included in the periodic reports filed with the SEC is made available to those responsible for preparing them in a complete and timely fashion.

"Internal Control Over Financial Reporting" is meant to ensure the integrity of the financial statements and guard the assets of the company. At the bookkeeping level, these procedures are designed to enforce the proper recording of income and expenditure so that revenues are deposited into the company's bank account and that unauthorized expenditures do not leave the company's bank account. At the executive level, these procedures are designed to prevent manipulation of revenues and expenses, such as illegal transfers from expense accounts to capital accounts, in which management may to tempted to engage in order to hit the end of the period "whispered numbers".

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that: (1) Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the registrant; (2) Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the registrant are being made only in accordance with authorizations of management and directors of the registrant; and (3) Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the registrant's assets that could have a material effect on the financial statements."

Because most periodic reports contain financial statements, there are some inevitable overlaps between the two sets of controls.

Purposes of Internal Control The establishment**,** maintenance and periodic evaluation of Internal Control Over Financial Reporting required by Section 404 of Sarbanes-Oxley is important in view of the fact that in auditing financial statements, outside accountants conduct and rely upon samplings and random checks rather than upon an exhaustive review of each transaction. This method of sampling and spot checking is justified if a reliable system of Internal Controls Over Financial Reporting is in place because it provides a level of comfort that there are checks and balances which monitor the day to day financial operations of the company. If on the other hand, no reliable Internal Control Over Financial Reporting exists, the accountant would have to conduct tests of transactions and perform additional analyses in order to accumulate sufficient evidence to support its opinion on the financial statements.

Procedures In the Internal Control Internal Control Over Financial Reporting should include policies and procedures that provide reasonable assurance that (i) records are maintained that fairly reflect purchase and sales of the company's assets, (ii) that transactions are properly recorded so as to permit the preparation of GAAP financial statements, (iii) receipts and expenditures are being made in an authorized fashion and (iv) unauthorized use of company assets that could have a material effect on the financial statements will be timely detected.

Management's Duty to Assess and Report on the Company's Internal Control In order to ensure the reliability of the Internal Control Over Financial Reporting at all times, management is required to evaluate the effectiveness of those controls on a periodic basis and to include a report of such evaluation in the annual report, which evaluation must be attested to by the company's outside accountants. Under the Section 404 proposed rules, management would have been required to evaluate the effectiveness of the internal controls quarterly. Recognizing that this would be too burdensome, the June 5th Rules only require quarterly evaluation of changes that have materially affected or are reasonably likely to materially affect, the Company's Internal Control Over Financial Reporting. Whereas a U.S. public company would have to report these changes quarterly, a foreign private issuer would only have to report them in their annual report.

The final rules preclude management from determining that a company's Internal Control Over Financial Reporting is effective if it identifies one or more material weaknesses in the company's Internal Control Over Financial Reporting. The adopting release clarifies, that the term "material weakness" has the same meaning as in the definition under GAAS and attestation standards. The final rules also specify that management's report must include disclosure of any "material weakness" in the company's Internal Control Over Financial Reporting identified by management in the course of its evaluation.

Management Procedures in Preparing the Report of the Effectiveness of Internal Control The June 5th Final Rules do not specify the method or procedures to be performed in an evaluation and such method will vary from company to company. They do, however, require management to maintain the documentation that supports its assessment of the effectiveness of the company's Internal Control Over Financial Reporting.

The documentation regarding the design of internal controls and the testing process should provide reasonable support (i) for the evaluation of whether the control is designed to prevent or detect material misstatement or omissions, (ii) for the conclusion that the tests were appropriately planned and performed and (iii) that the results of the tests were appropriately considered. In performing their evaluation of the design and effectiveness of the Internal Control Over Financial Reporting, management should review (i) the company's controls over initiating, recording, processing and reconciling account balances, classes of transactions and disclosures and related assertions included in the financial statements; (ii) controls related to the initiation and processing of non-routine and non-systematic transactions; and (iii) controls relating to the selection and application of appropriate accounting policies and controls relating to the prevention, identification and detection of fraud.

Evaluating the Internal Control Over Financial Reporting Although the SEC has not mandated any particular framework for the evaluation of the effectiveness of the Internal Control Over Financial Reporting, the framework used must be free of bias, permit qualitative and quantitative measurements, be sufficiently complete to include factors that would alter a conclusion about the effectiveness and be relevant to an evaluation of internal control.

The Outside Accountant's Attestation on Management's Internal Control Report and the Accounting Standards

As previously noted, the June 5th Final Rules require each annual report to include an attestation by the company's outside accountants in which the accounting firm expresses an opinion, or states that an opinion cannot be expressed and if not, why not, about management's assessment of the effectiveness of the company's Internal Control Over Financial Reporting in accordance with standards on attestation engagements. As discussed above, the PCAOB adopted Auditing Standard No. 2 which establishes standards for attestation reports.

Delegation of the Evaluation of the Internal Control over Financial Reporting to the Company's Outside Accountants Management cannot delegate the evaluation of the Internal Control Over Financial Reporting to the company's outside accountants because under the SEC's rules of auditor independence, one of the specifically prohibited non-audit services that an outside accountant may not provide to its audit client is the monitoring of internal controls. Nevertheless, because under Section 404 of Sarbanes-Oxley, the outside accountant must attest to the effectiveness of management's evaluation of the internal controls, the outside accountant must be involved in the assessment. Accordingly, management must be actively involved in the evaluation of the internal controls by the outside accountants and coordinate the process with them.

Compliance Dates On February 24, 2004, the SEC extended the dates by which companies must comply with the management report on Internal Control Over Financial Reporting Requirements of Section 404 of Sarbanes-Oxley. Under the SEC's new rules, companies that are Accelerated Filers (generally, defined as U.S. reporting companies that have a public float of at least $75 million as of the last business day of their most recently completed second fiscal quarter, that have been subject to the Exchange Act's reporting requirements for at least one year and that previously have filed at least one annual report), must begin to comply with the management report on Internal Control Over Financial Reporting on the date they file their first annual report for their first fiscal years ending on or after November 15, 2004. Under the Commission's initial rule, accelerated filers would have been required to comply with this on the date they filed their first annual report for fiscal years ending on or after June 15, 2004.

Companies that are not accelerated filers and foreign private issuers that file their annual reports on Form 20-F or Form 40-F will be required to comply with the management report on Internal Control Over Financial Reporting Requirements for their fiscal year ending on or after July 15, 2005. Under the SEC's initial rule, these non-accelerated filers and foreign private issuers would have been required to comply with their first annual report for their fiscal year ending on or after April 15, 2005.

The SEC similarly extended the compliance date for related requirements regarding evaluation of Internal Control Over Financial Reporting and management's certification requirements. Companies must comply with the evaluation requirements with respect to the company's first periodic report due after the first annual report that must include management's report on Internal Control Over Financial Reporting. The amended certification language must be provided in the first annual report required to contain management's internal control report and in all periodic reports thereafter.

Proposed Postponement of Final Phase-In Period
For Acceleration of Periodic Report Filing Dates

In September 2002, the SEC adopted amendments to accelerate the deadline for filing quarterly, annual and transition reports of Accelerated Filers (generally, defined as U.S. reporting companies that have a public float of at least $75 million as of the last business day of their most recently completed second fiscal quarter, that have been subject to the Exchange Act's reporting requirements for at least one year and that previously have filed at least one annual report). The SEC's rules phased in the new filing deadlines over a three year period, attempting to balance the market's need for timely information with the time companies need to prepare information without undue burden. In August, 2004, the SEC proposed to postpone for one year the final phase-in period for the accelerated filing of Forms 10-K and 10-Q in order to give filers and their auditors additional time to focus on the new internal control requirements. The SEC explained that its current rules would require Accelerated Filers to comply for the first time with the internal control reporting requirements while at the same time adjusting to a shortened annual report filing deadline from 75 days to 60 days for fiscal years ending on or after December 15, 2004. A number of companies and auditors had raised concerns about the internal controls and

accelerated filings deadlines which led the SEC to propose the postponement of the final phase-in period for accelerated periodic report filing dates.

The SEC said it is critical that all Exchange Act reporting companies completely and carefully implement the internal control requirements mandated by Section 404 of Sarbanes-Oxley to improve the accuracy and reliability of financial reporting. The SEC has urged companies to conduct thorough assessments of their Internal Control Over Financial Reporting. The PCAOB adopted Audit Standard No. 2 to provide for the audit of internal control and management's assessment, the SEC noted, so it is critical that financial management, external auditors and audit committees consult about the audit. Some commenters, including members of the Big Four accounting firms, had raised concerns that the final step in the acceleration of the periodic report filing deadlines might impede efforts to implement the internal control requirements with the care and attention that was needed. The SEC therefore concluded that a temporary postponement of the accelerated filing deadlines would benefit investors by providing filers with additional time to resolve any deficiencies or weaknesses that are discovered during the assessments of their internal controls.

Under the SEC's proposal, the phase-in period would resume in year four, for fiscal years ending on or after December 15, 2005.

The SEC advised that it remains committed to the concept of filing on a more timely basis and to the completion of the final phase-in period after the proposed one-year postponement. Among the issues commenters were asked to address was whether the final phase-in should be postponed for both annual and quarterly reports, given that only the annual reports must include the management's internal control report. The SEC also asked whether it should instead provide extensions to the filing deadlines only for accelerated filers that request it, or only for those companies that can demonstrate a need for an extension. Commenters were asked to submit their views by October 1, 2004.

Prohibiting Improper Influence on the Conduct of Audits

As required by Sarbanes-Oxley (§303), on May 20, 2003, the SEC published final rules which make it unlawful for any director or officer, or any person acting under their direction, to

“coerce, manipulate, mislead or fraudulently influence” an accountant engaged in an audit to render the financial statements materially misleading.

For the purposes of this rule, “being engaged in an audit” means any time that the accountant is called upon to make decisions or judgments regarding the company’s financial statements. This would cover any time during the accountant’s engagement, but could also include coercive conduct during discussions leading up to the accountant’s engagement and subsequent to the engagement when the accountant is being asked to issue a consent for the use of prior years audit reports.

The SEC’s final rules clarified that persons acting “under the direction” of an officer or director who could potentially be liable under the rule could include customers, vendors, or creditors of the company, who, under the direction of an officer or director of the company, provide misleading information to the company’s auditor or who enter into side agreements with management that enable the company to mislead the accountant. Others who might be covered include partners or employees at accounting firms as well as attorneys, securities professionals or other advisors if they are instructed by officers or directors, for example, to pressure an auditor to limit the scope of the audit, to issue a report on the company’s financial statements that is not warranted in the circumstances of the case, not to withdraw an issued report or not to communicate matters to the company’s audit committee.

In the final rules, the SEC pointed out that an attorney who negligently provides misleading information or a misleading legal analysis in response to a request by an accountant to provide certain information in connection with the accountant’s examination of the company’s financial statements, could be in violation of the rules even if there was no fraudulent or bad intent on the part of the attorney. While the SEC does not intend to hold any party accountable for honest and reasonable mistakes or to sanction those who actively debate accounting or auditing issues, the SEC will hold third parties responsible to the extent they do not exercise reasonable attention and care in such communications.

In its adopting release, the SEC stated that the rules could be violated by an attempt to influence the accountant even if that attempt did not actually succeed in affecting the audit or the review.

The types of conduct that the SEC believes might constitute improper influence include the following:

- Offering or paying the auditor bribes or other financial incentives, including offering continued engagement for audit or non-audit services;
- Providing the auditor with inaccurate or misleading legal analysis;
- Threatening to cancel or canceling existing non-audit or audit engagements if the auditor objects to the company's accounting;
- Seeking to have a partner removed from the audit engagement because the partner objects to the company's accounting;
- Blackmailing; and
- Making physical threats.

The SEC also noted that creating undue time pressure on the accountants, not providing them with information or not making oneself available to discuss matters with them on a timely basis, could under certain circumstances result in a violation of the rules.

The SEC's rules do not exempt foreign private issuers or other persons acting under their direction. These SEC's rules were effective June 27, 2003. Obviously the substance of these requirements should be followed as good business practice by private companies and non-profits alike.

Forfeiture of Incentive Compensation and Trading Profits

Section 304 of Sarbanes-Oxley provides that the CEO and CFO of any company having to make a financial statement restatement because of their "misconduct" (which is not defined in the law or in any rules issued to date) must reimburse the company for any bonuses or other incentive compensation, as well as any trading profits, during the 12-month period following the first public issuance or filing of the restated financial results. This statute does not exempt foreign private issuers, however, the SEC has the authority to exempt any person from this requirement as it deems necessary and appropriate.

Blackout Periods

Sarbanes-Oxley (§ 306) extends the applicability of any blackout period applicable to the company's pension funds to directors and executive officers, with respect to any shares received in connection with their employment or service. In the Enron case, the employee benefit plans were in blackout when the rumors began surfacing, and officers sold when the plans could not. Section 306 defines "blackout period" to mean a period of more than three consecutive business days during which the ability of 50% or more of the participants in the company's 401(k) and other ERISA individual account plans to trade company stock is suspended (other than pursuant to express investment restrictions timely disclosed).

The SEC has, as directed, consulted with the Department of Labor and has adopted rules (Regulation BTR), which became effective on January 26, 2003, that clarify Section 306 and prevent evasion with respect to insider trading during blackout periods under an issuer's "individual account plan(s,)"[18] which include 401(k) plans, profit-sharing plans and other defined contribution plans. The rules also clarify the definition of "blackout period." The rules generally prohibit directors and executive officers of covered companies from purchasing or selling or otherwise acquiring or transferring, directly or indirectly, any equity security of the company during any blackout period if the security was acquired in connection with the director's or officer's employment with the company. The new rules do not apply to a blackout period affecting a plan "maintained outside the United States primarily for the benefit of persons located outside the United States," since such plans are not considered "individual account plans."

For foreign private issuers, if the number of participants or beneficiaries located in the United States in individual account plans maintained by a foreign private issuer who are affected by a temporary trading suspension in issuer equity securities either exceeds (i) 15% of the total number of employees of the issuer and its consolidated subsidiaries or (ii) 50,000 participants

[18] The term individual account plan means "a pension plan which provides for an individual account for each participant and for benefits based solely upon the amount contributed to the participant's account, and any income, expenses, gains and losses, and any forfeitures of accounts of other participants which may be allocated to such participant's account, except that such term does not include a one-participant retirement plan ... nor does it include a pension plan in which participation is limited to directors of the issuer."

and beneficiaries, and the concurrent 50% test is satisfied, then the directors and officers are prohibited from trading.

With respect to foreign private issuers, covered directors include only executive directors and not outside directors, and covered officers include only the company's principal executive officers, principal financial officers and principal accounting officers. The rules do not extend the statutory trading prohibitions to cover non-management directors of foreign private issuers.

Sarbanes-Oxley (§306(a)(6)) and the rules require companies to provide timely notice to its directors, executive officers and to the SEC of the imposition of a blackout period that triggers the trading prohibition. The SEC's adopting release specifies that notice will be considered timely if provided no later than 5 business days after the company receives notice of the blackout from the pension plan administrator required by the Department of Labor's rules. If no such notice is received by the company, the company must provide such notice at least 15 calendar days before the actual or expected beginning date of the blackout period. Companies must submit notice to the SEC on a Form 8-K on the same day notice is transmitted to directors and executive officers. Blackout notices must be filed by the foreign private issuer with the SEC, preferably on Form 6-K or otherwise as an exhibit to the company's Form 20-F or 40-F.

Trading profits realized by a covered director or officer in violation of Section 306 are recoverable by the company in a direct or derivative action.

Standards of Professional Conduct for SEC Counsel

Sarbanes-Oxley required the SEC, within 180 days of enactment, to promulgate rules of professional responsibility for securities lawyers (§ 307). Under the law, the rules had to require lawyers to report evidence of any material violation of securities law or breach of fiduciary duty to the issuer's chief legal counsel or chief executive officer. If the counsel or CEO did not "appropriately" respond, then the attorney would be required to report the evidence to the audit committee, the Board of Directors or other committee composed of non-employee directors.

The U.S. legal bar opposed these provisions, objecting that they did not filter the baseless rumor from the substantive claim, and if the test for the new law is how it would have tempered or avoided the long line of scandals, there is no evidence that it would have or could have, since the lawyers, to the extent involved, seem to have reviewed and in good faith approved the

relevant issues. Many argued that the breadth and ambiguity of these new provisions imperils the attorney-client privilege and inhibits the candid discussion of problems which could result in the cure of a potential issue before it fomented into a violation or worse.

The countervailing view emphasized that there are cases where the lawyer certainly must go to the Board or even beyond.

After vigorous debate, the SEC enacted attorney conduct rules, which became effective August 5, 2003. They apply to attorneys appearing and practicing before the SEC and require an attorney to report evidence of material violations of U.S. securities laws or breach of fiduciary duty or similar violations by the issuer or agent of the issuer to the Chief Legal Officer (the "CLO") or to both the CLO and the CEO.

If the officer receiving the report does not "appropriately respond", then the attorney must report the violations "up-the-ladder" within the issuer to the audit committee or another independent committee of the Board or directly to the Board.

In lieu of reporting evidence of a material violation to the CEO or CLO, an attorney may report the violation to the qualified legal compliance committee ("QLCC"), if the QLCC was established by the Board of Directors prior to the event of misconduct being reported. An attorney who reports evidence of a material violation to such a QLCC has satisfied his or her obligation to report such evidence and is not required to assess the issuer's response to the reported evidence of a material violation. The QLCC shall be responsible for responding to the evidence of a material violation reported to it.

The SEC's attorney conduct rules apply to attorneys for foreign private issuers, but do not apply to a "non-appearing foreign attorney," who is someone admitted to practice in a jurisdiction outside the United States, not holding himself out as practicing, and not giving legal advice regarding, United States federal or state securities laws (except in consultation with a U.S. lawyer), and either (i) conducting activities that would constitute appearing and practicing before the SEC only incidentally to, and in the ordinary course of, the practice of law in a jurisdiction <u>outside</u> the United States; or (ii) appearing and practicing before the SEC only in consultation with counsel (other than a non-appearing foreign attorney) admitted or licensed to practice in a state or other U.S. jurisdiction.

Foreign attorneys who practice exclusively outside the U.S. will not have to comply with the new attorney conduct rules if they are forbidden to do so by foreign law, and the new rules specifically provide that they do not create a civil cause of action but rather are enforceable only by the SEC.

Following vigorous objections from the American Bar, the SEC deferred consideration on the proposed "noisy withdrawal" requirements that attorneys withdraw from a matter if they did not receive an "appropriate response" after reporting evidence of a material violation "up-the-ladder" and that they notify the SEC of their withdrawal and the SEC also proposed an alternative reporting requirement for issuers which has also been vigorously debated.

Fair Funds for Investors

Sarbanes-Oxley (§308) establishes victim compensation funds called "Fair Funds for Investors," which specifies that any required disgorgement or civil penalties for securities law violations may be added to the disgorgement fund for the benefit of the victims of the violation.

The SEC has adopted rules relating to Fair Funds and disgorgement plans. Under the rules, the SEC is authorized to create a Fair Fund in any administrative proceeding in which a final order is entered against a respondent requiring disgorgement and payment of a civil money penalty. The rules would permit either the SEC or the hearing officer, as appropriate, to oversee the administration of both the disgorgement funds and Fair Funds. The rules would continue the practice of allowing the SEC or the hearing officer at any time to order a party to submit a plan for the administration of either a Fair Fund or a disgorgement fund. Unless ordered otherwise, the Division of Enforcement must submit a plan within 60 days after the respondent has tendered the funds or other assets pursuant to the SEC's order to pay disgorgement and, if applicable, civil money penalty and any appeals of the SEC's order have been waived or completed, or appeal is no longer available.

The rules would require that both Fair Fund or disgorgement fund plans provide for: (i) receiving and holding additional funds; (ii) identifying categories of persons who are potentially eligible to receive funds; (iii) providing notice to potentially eligible persons of the fund's existence and their potential eligibility; (iv) handling claims; (v) termination of the fund and the

disposition of any remaining assets; (vi) administration of the fund and (vii) such other provisions as the SEC or hearing officer may deem appropriate.

The rules would require that notice of either a proposed disgorgement plan or a proposed Fair Fund plan be published in the SEC Docket, on the SEC's website and such other publications as the SEC or the hearing officer directs. The notice must indicate how to obtain copies of the proposed plan and provide information on how to submit comments to the SEC. The SEC also proposes to post the notice of a proposed plan on its website. Under the rules, 30 days after notice of the plan, the SEC may approve, modify, or disapprove the proposed plan. The SEC may order a publication of a modified plan prior to adoption.

The rules would permit the SEC or hearing officer to appoint any person, including an SEC employee, as fund administrator. Either the SEC or the hearing officer would be able to remove an administrator.

Finally, the rules make clear that no person may be granted the right to intervene or appear in a proceeding to challenge an order of disgorgement, an order creating a Fair Fund, an order approving, modifying or disapproving a disgorgement plan or a Fair Fund plan, or any determination relating to a plan based solely upon the person's eligibility to participate in a fund based on a private right of action.

Disclosure of Off-Balance Sheet Transactions and Disclosures of Contractual Obligations

Disclosure of Off-Balance Sheet Transactions Section 401 of Sarbanes-Oxley and the SEC's related final rules, published on January 28, 2003, require annual and quarterly reports filed with the SEC to disclose all material off-balance sheet arrangements in a separately captioned statement in the Management's Discussion and Analysis (the "MD&A") section. Companies must disclose off-balance sheet arrangements[19] that have or are reasonably likely to

[19] The SEC defined the term "off-balance sheet arrangement" as any contractual arrangement to which an entity not consolidated with the company is a party, under which the company has: (i) any obligation under a guarantee or similar arrangement; (ii) a retained or contingent interest in assets transferred to such unconsolidated entity or similar arrangement that serves as credit liquidity or market risk support to that entity for such assets; (iii) any obligation under certain derivative instruments or (iv) any obligation under a material variable interest, held by the company in an unconsolidated entity that provides financing, liquidity, market risk or credit risk support to the company, or engages in leasing, hedging or research and development services with the company.

have a current or future effect on its financial condition, changes in financial condition, revenues and expenses, results of operations, liquidity, capital expenditures and capital resources.

The SEC's rules require this disclosure in each document that contains an MD&A, including annual reports, quarterly reports, registration statements and proxy or information statements that are required to include financial statements. In particular, the SEC requires that the following four items must be disclosed to the extent necessary for an understanding of a company's off-balance sheet arrangements and their effects:

(i) the nature and business purpose of the company's off-balance sheet arrangements;

(ii) the importance of the off-balance sheet arrangements to the company for liquidity, capital resources, market risk or credit risk support or other benefits;

(iii) (a) the amounts of revenues, expenses and cash flows of the company arising from the arrangements, (b) the nature and total amount of any interests retained, securities issued and other indebtedness incurred by the company in connection with such arrangements and (c) the nature and amount of any other obligations or liabilities of the company arising from the arrangements that are, or are reasonably likely to become, material and the triggering events and circumstances that could cause them to arise and

(iv) known events, demands, commitments, trends or uncertainties that are reasonably likely to affect the availability or benefits to the company of material off-balance sheet arrangements and the course of action that it has taken (or proposes to take) in response to a termination or material reduction in the availability of an off-balance sheet arrangement that provides material benefits.

In addition to the required disclosures listed in items (i) - (iv) above, companies must disclose any other information that the company believes is necessary for an understanding of the company's off-balance sheet arrangements and its material effects.

The SEC's rules clarify that companies are not required to make disclosures of off-balance sheet arrangements until there is an unconditionally binding definitive agreement or a settlement transaction.

The rules apply to foreign private issuers that file annual reports on Form 20-F or Form 40-F. Foreign private issuers will generally not be required to update their MD&A disclosure more frequently than annually. The MD&A disclosure provided by foreign private issuers must focus on the primary financial statements, whether those are prepared in accordance with GAAP or non-U.S. GAAP. Foreign private issuers, whose primary financial statements are prepared in accordance with non-U.S. GAAP, should include a discussion of reconciliation to U.S. GAAP and any difference between foreign and U.S. GAAP if such information would be necessary to understand the financial statements as a whole.

The SEC's adopting release clarifies that the definition of "off-balance sheet arrangement" for foreign private issuers encompasses the same type of arrangements as for U.S. companies. To determine the types of arrangements subject to disclosure, a non-U.S. public company must assess its guarantee contracts and variable interests pursuant to U.S. GAAP.

Companies, including foreign private issuers, must comply with the off-balance sheet arrangement disclosure requirements in registration statements, annual reports and proxy or information statements that are required to include financial statements for their fiscal years ending on or after June 15, 2003. Companies which are privately-held, and not-for-profit corporations, should obviously take care that their directors understand the substance of these arrangements, if any, and also clearly appreciate any significant risks involved.

Disclosure of Contractual Obligations In addition, the SEC enacted rules requiring companies to disclose in tabular format the amounts of payments due under various contractual obligations in the MD&A. Companies must provide information in the table, as of the latest fiscal year end balance sheet date, for the following contractual obligations: (i) long-term debt obligations, (ii) capital lease obligations, (iii) operating lease obligations, (iv) purchase obligations and (v) other long-term liabilities reflected on the company's balance sheet under GAAP.

Companies filing small business reporting forms are not required make these tabular disclosures.

The table must specify (in each category) those contractual obligations that are due in: less than 1 year, 1-3 years, 3-5 years and those that are due in more than 5 years.

The SEC's rules allow companies to disaggregate certain categories suitable to a company's specific business, but the table must include all of the obligations that are listed in (i)-(v) above.

Companies, including foreign private issuers, must include the table of contractual obligations in annual reports, registration statements, and proxy or information statements that are required to include financial statements for fiscal years ending on or after December 15, 2003.

Safe Harbor for Forward-Looking Information In Connection With Disclosure of Off-Balance Sheet Transactions and Contractual Obligations Disclosures Because some of the disclosures required by the SEC's rules relating to off-balance sheet transactions and the table of contractual obligations would require disclosure of forward-looking information, the SEC's final rules include a statutory safe harbor for forward-looking information to protect companies against legal actions that are based upon allegations of misstatements.

The statutory safe harbor provides three bases for a company to claim the protection against liability for forward-looking statements.

First, a company may choose to identify the statement as a forward-looking statement and include meaningful, cautionary statements that identify important factors that could cause actual results to differ materially from those in the forward looking statements.

Second, a company will be protected from any forward-looking statement that is not material.

Third, a company is protected from private liability if the plaintiff fails to prove that the forward-looking statement was made by or with the approval of an executive officer of the company who had actual knowledge that it was false or misleading.

The statements of reporting companies, persons acting on behalf of the reporting companies, outside reviewers retained by them and underwriters are covered under the statutory safe harbor.

Use of Non-GAAP Financial Statements

Regulation G Section 401 of Sarbanes-Oxley directed the SEC to adopt rules providing that pro forma financial information included in any periodic or other report filed with the SEC, or in any public disclosure or press release, be presented in a manner that (i) does not contain any misleading information and (ii) reconciles the pro forma financial information with the financial condition and results of operations of the company under GAAP.

In response to this directive, the SEC adopted Regulation G in its final rules published on January 22, 2003.

Under Regulation G, whenever a company discloses material information to the public that includes a non-GAAP financial measure,[20] the company must disclose: (i) a presentation of the most directly comparable financial measure calculated in accordance with GAAP and (ii) a reconciliation of the disclosed non-GAAP financial measure to the most directly comparable GAAP financial measure.

Regulation G also includes the general disclosure requirement that a company (or person acting on its behalf) cannot make public a non-GAAP financial measure that contains an untrue statement of a material fact or omits a material fact that is necessary in order to make the non-GAAP financial measure not misleading.

Regulation G applies to foreign private issuers, subject to a limited exception. Regulation G does not apply to a foreign private issuer if: (i) its securities are listed or quoted outside the U.S.; (ii) the non-GAAP financial measure is not derived from or based on a measure calculated in accordance with U.S. GAAP and (iii) the disclosure is made by or on behalf of the company outside the United States, or is included in a written communication that is released only outside the United States.

Foreign private issuers can rely on this exception even if: (i) U.S. journalists, foreign journalists or other third parties have access to it; (ii) the information appears on company web sites that are accessible from the United States (so long as the web sites are not targeted at

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[20] Under Regulation G, a non-GAAP financial measure is a numerical measure of a company's financial performance, financial position or cash flow that: (i) excludes amounts that are included in the most directly comparable measure calculated in accordance with GAAP or (ii) includes amounts that are excluded from the most directly comparable measure under GAAP.

persons located in the United States); (iii) a written communication is released in the United States as well as outside the United States, so long as the communication is released in the United States contemporaneously with or after the release outside the United States (and is not otherwise targeted at persons located in the United States) or (iv) following the disclosure or release outside the United States, the information is included in a submission to the SEC on Form 6-K.

Regulation G applies to all disclosures and press releases issued after March 28, 2003.

Non-GAAP Financial Disclosures and SEC Filings In order to implement the requirements of §401 of Sarbanes-Oxley relating to the use of non-GAAP financial disclosures in SEC filings, the SEC amended Item 10 of Regulation S-K (and Item 10 of Regulation S-B).

While Regulation G applies to every disclosure of non-GAAP financials measures, Item 10 of Regulation S-K applies only to materials filed with the SEC.

Further, the requirements of Item 10 of Regulation S-K are more rigorous than the requirements of Regulation G. Under Item 10 of Regulation S-K, filings with the SEC that include a non-GAAP financial measure generally must include: (i) a presentation, with equal or greater prominence, of the most directly comparable financial measure calculated and presented in accordance with GAAP; (ii) a reconciliation of the difference between the non-GAAP financial measure with the most directly comparable GAAP measure; (iii) a statement explaining why the company's management believes that the presentation of the non-GAAP financial measures provides useful information to investors; and (iv) to the extent material, a statement disclosing the additional purposes, if any, for which the company's management uses the non-GAAP financial measures.

In addition to required disclosures (i)-(iv) above, Item 10 of Regulation S-K prohibits the use of certain kinds of non-GAAP financial measures.

Specifically, the SEC prohibited the use of the following:

(i) excluding charges or liabilities that required or will require cash settlement (other than EBIT and EBITDA);

(ii) adjusting a non-GAAP performance measure to eliminate or smooth items identified as non-recurring, infrequent or unusual, when the nature of the charge or gain is such that it is reasonably likely to recur, or have previously occurred, within two years;

(iii) presenting non-GAAP financial measures on the face of the company's financial statements prepared in accordance with GAAP or in the accompanying notes;

(iv) presenting non-GAAP financial measures on the face of any pro forma financial information required to be disclosed by Article 11 of Regulation S-X;

(v) using titles or descriptions of non-GAAP financial measures that are the same as, or confusingly similar to, titles or descriptions used for GAAP measures.

The SEC amended Form 20-F (but not Form 40-F) to incorporate Item 10 of Regulation S-K. The SEC indicated that a non-GAAP financial measure that would otherwise be prohibited is permitted in a Form 20-F filing of a foreign private issuer if the measure is: (i) required or expressly permitted by the standard setter that establishes the generally accepted accounting principles used in the foreign private issuer's primary financial statements and (ii) included in the foreign private issuer's annual report or financial statements used in its home country.

The amendments to Item 10 of Regulation S-K and Form 20-F apply to any annual or quarterly report filed with respect to a fiscal period ending after March 28, 2003.

If and to the extent that a private company or a non-profit discloses non-GAAP information for any purpose, the directors should at the least understand the purpose and effect of such disclosures, even though obviously the specific disclosures required by Sarbanes-Oxley are not required.

Rapid Disclosure of Information Concerning Material Changes in Financial Condition or Operations

Earnings Releases Sarbanes-Oxley (§409) requires that companies which file reports with the SEC must disclose to the public on a "rapid and current basis" information concerning material changes in the financial condition and operations of the company, in plain English.

In order to carry out the requirements of §409, the SEC added a new item to Form 8-K (which as discussed below does not apply to foreign private issuers), to require companies to

furnish to the SEC on a Form 8-K releases or announcements that contain material, non-public information regarding the company's results of operation or financial condition for an annual or quarterly fiscal period that has ended. In its rules adopted on January 28, 2004, the SEC required companies to include these disclosures under Item 12 of Form 8-K. However, in its rules adopted on March 16, 2004, the SEC reorganized the Form 8-K items. The SEC now requires issuers to disclose such earnings releases and announcements under new Item 2.02 within four business days.

The new Item 2.02 requires the company to identify briefly the announcement and include the announcement as an exhibit to Form 8-K. This applies regardless or whether the release or announcement contains non-GAAP financial measures.

Of course, companies that furnish to the SEC earning releases or announcements that contain non-GAAP financial statements will also need to comply with requirements relating to SEC filings as specified above, including a presentation, with equal or greater prominence, of the most directly comparable financial measure calculated and presented in accordance with GAAP, a reconciliation of the difference between the non-GAAP financial measure with the most directly comparable GAAP measure and a statement explaining why the company's management believes that the presentation of the non-GAAP financial measures provides useful information to investors.

A Form 8-K is not required to be furnished to the SEC under Item 2.02 if the material, non-public information is disclosed orally, telephonically, by webcast, by broadcast, or by similar means in a presentation that is complementary to, and occurs within 48 hours after, a related, written release or announcement that triggers the requirements of Item 2.02 if:

(i) the related, written announcement or release that has been furnished on Form 8-K prior to the presentation;

(ii) the presentation is broadly accessible to the public by dial-in conference call, by webcast, by broadcast, or by similar means;

(iii) the financial and other statistical information contained in the presentation is provided on the company's web site, together with any information required by Regulation G; and

(iv) the presentation was announced by a widely disseminated press release, that included instructions on when and how to access the presentation and the location on the company's web site where the information would be available.

Foreign private issuers generally do not file Form 8-Ks and therefore are not subject to the additional Form 8-K filing requirement. Foreign private issuers, however, would still have to file any material information publicly released in their home jurisdiction on Form 6-K. U.S. companies were required to furnish earnings releases and similar materials to the SEC on Form 8-K for earnings releases and similar announcements made after March 28, 2003.

Additional Form 8-K Disclosure Requirements and Acceleration of Filing Dates On March 16, 2004, the SEC adopted final rules which expand the number of events that are reportable on Form 8-K. In addition, the rules: (i) reorganize the Form 8-K disclosure items into topical categories, (ii) shorten the Form 8-K filing deadline for most reportable events to four business days after the occurrence of a triggering event and (iii) create a limited safe harbor from liability for failure to file certain of the required Form 8-K reports.[21] These rules, which became effective for U.S. domestic companies that are required to file periodic reports with the SEC on August 23, 2004, are also responsive to the "real time issuer disclosure" mandate in Section 409 of the Sarbanes-Oxley.

The following is a brief description of the new disclosure items to Form 8-K.

Entry into a Material Definitive Agreement New Item 1.01 requires disclosure of material definitive agreements entered into by a company that are not made in the ordinary course of business, and any material amendment to a material definitive agreement (even if the underlying agreement previously has not been disclosed). Only agreements which provide for obligations that are material and enforceable by or against a company are required to be disclosed under this item, regardless of whether the material definitive agreement is enforceable subject to stated conditions. The SEC encourages companies to file the material agreement as an exhibit to the Form 8-K when feasible (particularly when no confidential treatment is requested); however, a company may delay the filing of the exhibit until its next periodic report or registration statement.

[21] SEC Release No. 33-8400 (March 16, 2004).

Termination of a Material Definitive Agreement New Item 1.02 requires disclosure of the termination of a material definitive agreement, if such termination is material to the company and is not as a result of expiration of the agreement on a stated termination date or completion of all of the parties' obligations under such agreement. Disclosure under this item is not required until the agreement has been terminated, and therefore no disclosure is required during negotiations or discussions regarding termination. If the company believes, in good faith, that a material definitive agreement has not been terminated, it is not required to file a Form 8-K under this item, unless the company has received a notice of termination pursuant to the agreement.

Creation of a Direct Financial Obligation or an Obligation under an Off-Balance Sheet Arrangement New Item 2.03 requires disclosure on Form 8-K if a company becomes (i) obligated under a material direct financial obligation, or (ii) directly or contingently liable for a material obligation arising out of an off-balance sheet arrangement. Disclosure of a direct financial obligation under this item is required when a company enters into an agreement enforceable against it, whether or not subject to conditions, under which such obligation will arise or be created, or if there is no such agreement, upon the closing or settlement of the transaction or arrangement under which such obligation arises or is created. Disclosure regarding a contingent obligation under an off-balance sheet arrangement is required under this item even if a company is not a party to the transaction or agreement creating such obligation, in which case the four business day period for reporting the event under this item will begin on the earlier of the fourth business day after the contingent obligation is created or arises and the day on which an executive officer becomes aware of the contingent obligation. A company must disclose its entry into a facility, program or similar arrangement that creates or may give rise to direct financial obligations in connection with multiple transactions, and disclose its obligations, if material, as they arise or are created (including when a series of previously undisclosed individually immaterial obligations become material in the aggregate).

Triggering Events that Accelerate or Increase a Direct Financial Obligation or an Obligation under an Off-Balance Sheet Arrangement New Item 2.04 requires a company to file a Form 8-K report if a triggering event (which includes an event of default, event of acceleration or similar event) occurs causing (i) the increase or acceleration of a direct financial obligation or an obligation under an off-balance sheet arrangement, or (ii) a contingent obligation under an

off-balance sheet arrangement to become a direct financial obligation; and the consequences of the event are material to the company.

Similar to new Item 2.03, disclosure of a triggering event in respect of an obligation under an off-balance sheet arrangement is required under this item whether or not a company is also a party to the transaction or agreement under which such event occurs. Disclosure is not required unless and until a triggering event has occurred in accordance with the terms of the relevant agreement, transaction or arrangement (including any required notice of the occurrence of a triggering event and the satisfaction of all conditions to such occurrence, except the passage of time). Similar to new Item 1.02, disclosure is not required if a company believes, in good faith, that a triggering event has not occurred, unless the company has received a notice pursuant to the terms of the agreement that such event has occurred; however, if a company nevertheless elects to file a Form 8-K under this item, it may include a statement of its good faith belief and its reasons for such belief, in which case an amendment under this item may be required if the company's conclusion as to the triggering event changes due to a loss of, or change in, its good faith.

Costs Associated with Exit or Disposal Activities New Item 2.05 requires disclosure on Form 8-K when the Board of Directors, a committee of the Board of Directors, or an authorized officer or officers, if Board action is not required, commits a company to an exit or disposal plan or otherwise disposes of a long-lived asset or terminates employees under a plan of termination described in FASB Statement of Financial Accounting Standards No. 146 (Accounting for Costs Associated with Exit or Disposal Activities), as a result of which material charges will be incurred by the company under applicable GAAP. A company must file a Form 8-K regarding its commitment to a course of action under which it will incur a material charge even if at the time of filing it is unable to make a good faith estimate of the amount of the charges, in which case the company must file an amendment to its Form 8-K to include an estimate within four business days after it formulates one.

Material Impairments New Item 2.06 requires disclosure on Form 8-K when a company's Board of Directors, a committee of the Board of Directors, or an authorized officer or officers, if Board action is not required, concludes that a material charge for impairment to one

or more of its assets, including, without limitation, an impairment of securities or goodwill, is required under applicable GAAP. No Form 8-K disclosure is required pursuant to this item if such conclusion is made in connection with the preparation, review or audit of financial statements at the end of a fiscal quarter or year and the conclusion is disclosed in the company's Exchange Act report for that period.

Notice of Delisting or Failure to Satisfy a Continued Listing Rule or Standard; Transfer of Listing New Item 3.01 requires a company to file a Form 8-K if any of the following events occurs in connection with the delisting of any class of a company's common equity from the national securities exchange or association that maintains the principal listing for such class of securities:

(i) The company receives a notice from such exchange or association indicating that: (a) the company or such class of its securities does not satisfy a rule or standard for continued listing on the exchange or association; (b) the exchange has submitted to the SEC an application to delist such class of the company's securities; or (c) the association has taken all necessary steps under its rules to delist the security.

(ii) The company has notified such exchange or association that it is aware of any material noncompliance with a rule or standard for continued listing on the exchange or association.

(iii) The exchange or association issues a public reprimand letter or similar communication indicating that the company has violated a rule or standard of the exchange or association.

(iv) The company's Board of Directors or a committee thereof, or if Board action is not required, an authorized officer or officers, has taken definitive action to cause a class of its common equity to be withdrawn or terminated from such exchange or association, or the transfer of its securities to another exchange or quotation system.

Disclosure under this item is required even if the company has the benefit of a grace period or similar extension period during which it may cure the deficiency that triggers the

disclosure requirement. However, the SEC noted in its final rule that an early warning notice that merely informs a company that it is in danger of non-compliance with a continued listing standard will not trigger a disclosure obligation under this item. The SEC noted that if the warning notice informs the company that it is out of compliance with a rule or standard for continued listing, but that the company will not be delisted if it cures the problem within a specified time, such a notice will trigger a Form 8-K filing requirement. It is anticipated that in the typical involuntary delisting process two Form 8-K filings would be required: (i) an initial filing when the company receives or gives notice that it no longer complies with a continued listing standard; and (ii) a second filing upon the company's receipt of a notice regarding the actual delisting of its securities.

Non-Reliance on Previously Issued Financial Statements or a Related Audit Report or Completed Interim Review New Item 4.02 requires a company to file a Form 8-K (i) when its Board of Directors, a committee of the Board of Directors, or an authorized officer or officers, if Board action is not required, concludes that any of the company's previously issued financial statements covering one or more years or interim periods should no longer be relied upon because of an error in such financial statements, or (ii) if a company receives advice or notice from its independent accountant that disclosure should be made or action should be taken to prevent future reliance on a previously issued audit report or completed interim review related to previously issued financial statements.

If a Form 8-K is filed under this item in respect of advice or notice received from a company's independent accountant, the company must provide the accountant with a copy of its disclosures no later than the day it files them with the SEC, and also must request the accountant to promptly furnish to it a letter addressed to the SEC stating whether the accountant agrees with the statements made by the company and, if not, the respects in which it does not agree. The company must then file such letter as an exhibit to the filed Form 8-K, by amendment to such filing, within two business days of its receipt.

The following is a brief description of the new disclosure items, which were transferred from periodic reports to Form 8-K.

Unregistered Sales of Equity Securities New Item 3.02 requires disclosure on Form 8-K of certain sales of a company's equity securities in a transaction that is not registered under the Securities Act of 1933. This disclosure is currently required in a company's annual report (on Form 10-K or Form 10-KSB) and quarterly report (on Form 10-Q or Form 10-QSB). The disclosure of a sale of unregistered equity securities on Form 8-K has, however, been limited to a quantitative threshold: a Form 8-K filing is not required if the equity securities sold in the aggregate since the company's last Form 8-K or periodic report constitute less than 1% (or 5% for a small business issuer) of the company's outstanding securities of that class. A company will be required to continue to report unregistered sales of equity securities that are less than such threshold in their periodic reports. The obligation to disclose information under this item is triggered when a company enters into an agreement enforceable against it, whether or not subject to conditions, under which the equity securities are to be sold, or if there is no such agreement, within four business days after the occurrence of the closing or settlement of the transaction.

Material Modifications to Rights of Security Holders New Item 3.03 requires a company to disclose material modifications to the rights of the holders of any class of the company's registered securities and to briefly describe the general effect of such modifications on such rights. The substance of this disclosure is currently required in a company's quarterly report (on Forms 10-Q or 10-QSB).

The following is a brief description of the expanded disclosure of Form 8-K disclosure items.

Departure of Directors or Principal Officers; Election of Directors; Appointment of Principal Officers New Item 5.02 broadens the scope of the disclosure currently required under Form 8-K when a director resigns or declines to stand for re-election and expands the events that require disclosure with respect to changes in the service of directors and principal officers. The following events trigger disclosure under new Item 5.02:

(a) A director has resigned or refuses to stand for re-election to the Board of Directors since the last annual meeting of stockholders because of a disagreement with the company, known to an executive officer of the company, on any matter relating to the company's operations, policies or practices, or if a director has

been removed for cause from the Board of Directors. Any written correspondence furnished by the director to a company concerning the circumstances surrounding such resignation, refusal or removal must be filed as an exhibit to the Form 8-K. A company must provide the director with a copy of its disclosures no later than the day it files them with the SEC, and must also provide the director with the opportunity to furnish to it a letter addressed to the company stating whether such director agrees with the company's disclosures and, if not, the respects in which he or she does not agree. The company must then file any such letter it receives as an exhibit to the filed Form 8-K, by amendment to such filing, within two business days after its receipt.

(b) A company's principal executive officer, president, principal financial officer, principal accounting officer, principal operating officer or any person performing similar functions retires, resigns, or is terminated from that position, or a director retires, resigns, is removed or declines to stand for re-election under circumstances not described in the foregoing paragraph.

(c) A company appoints a new principal executive officer, president, principal financial officer, principal accounting officer, principal operating officer or person performing similar functions. If a company intends to make a public announcement of such appointment other than by means of a report on Form 8-K, it may delay filing a Form 8-K under this item until the day it makes such public announcement.

(d) A new director is elected to the Board of Directors, except by a vote of security holders at an annual or special meeting.

Amendments to Articles of Incorporation or Bylaws; Change in Fiscal Year New Item 5.03 changed the disclosure currently required under Form 8-K if a company determines to changes its fiscal year from that used in its most recent filing. Under the new item, companies with securities registered under Section 12 of the Exchange Act must disclose any amendment to its articles of incorporation or bylaws if the company did not propose the amendment in previously filed proxy or information statement. Under the new item, if a company changes its

fiscal year from that used in its most recent filing with the SEC by means other than, (i) a submission to a vote of security holders through solicitation of proxies or otherwise, or (ii) by an amendment to its articles of incorporation or bylaws, the company must state the date of that determination, the date of the new fiscal year end and the form on which the report covering the transition period will be covered. A company is only required to file the text of an amendment to the articles of incorporation or bylaws as an exhibit to Form 8-K under this item, in which case it must file the restated articles of incorporation or bylaws as an exhibit to its next periodic report.

Accelerated Filing Deadline Under the final rules, U.S. public companies are required to file reports on Form 8-K within four business days of a triggering event. The amendments do not affect the current filing deadline for disclosures under Regulation FD (Item 7.01), voluntary disclosures (Item 8.01) and certain exhibits.

Limited Safe Harbor; Eligibility to Use Form S-2 and S-3 and to Rely on Rule 144 The SEC adopted a new limited safe harbor from public and private claims under the anti-fraud provisions of Section 10(b) and Rule 10b-5 under the Securities Exchange Act of 1934 for a failure to timely file a Form 8-K regarding seven disclosure items[22]. The safe harbor for such items states that no failure to file a report on Form 8-K that is required solely pursuant to the provisions of Form 8-K shall be deemed to be a violation of such Section 10(b) and Rule 10b-5. Accordingly, material misstatements or omissions in a Form 8-K and failure to disclose information required to be disclosed apart from under a Form 8-K will continue to be subject to liability under such Section 10(b) and Rule 10b-5. The safe harbor extends only until the due date of the company's next periodic report, in which the company must provide the required disclosure.

In addition, the SEC revised Form S-2 and Form S-3 under the Securities Act of 1933 to provide that companies that fail to timely file a Form 8-K under the seven items covered by the Section 10(b) and Rule 10(b)(5) safe harbor will not lose their eligibility to use such forms. With

[22] Items 1.01 (Entry into a Material Definitive Agreement), 1.02 (Termination of a Material Definitive Agreement), 2.03 (Creation of a Direct Financial Obligation or an Obligation under an Off-Balance Sheet Arrangement of a Registrant), 2.04 (Triggering Events that Accelerate or Increase a Direct Financial Obligation under an Off-Balance Sheet Arrangement), 2.05 (Costs Associated with Exit or Disposal Activities), 2.06 (Material Impairments), 4.02(a) (Non-Reliance on Previously Issued Financial Statements or a Related Audit Report or Completed Interim Review (in the case where a company makes the determination and does not receive a notice described in Item 4.02(b) from its accountant)).

respect to the other Form 8-K items, failure to timely file a Form 8-K pursuant to any of such items will continue to result in a loss of Form S-2 or Form S-3 eligibility for the 12 months following the Form 8-K due date.

The SEC also revised Rule 144 under the Securities Act to provide that the "current public information" condition under Rule 144(c) will be satisfied even though the company has not filed all required Forms 8-K.

Obligatory Electronic Filing for Forms 3, 4 and 5

Foreign private issuers are exempt from the short-swing profit recovery provisions of Section 16 of the Exchange Act, and therefore the relevant changes to the reporting requirements for officers, directors, and 10% shareholders are inapplicable. Briefly, the changes now require reports of trades by such persons by the second-following business day, and the reports now must be filed electronically and posted on the company's web site.

Loans to Insiders

Sarbanes-Oxley (§ 402), effective in August 2002, prohibits public companies (other than investment companies) from extending, arranging or renewing credit to any director or executive officer, other than certain specified margin or other loans made in the ordinary course of business (such as consumer loan companies).

Extensions of credit maintained by the company on July 30, 2002 may continue but may not be extended or otherwise materially modified.

Under Section 402 of Sarbanes-Oxley, loans by U. S. banks and thrifts are not subject to the prohibition if the lender is FDIC-insured and the loans are subject to the insider lending restrictions of the Federal Reserve Act. Sarbanes-Oxley did not exempt foreign banks whose securities are registered with the SEC. On April 26, 2004, the SEC adopted rules to remedy the disparate treatment of foreign banks that satisfy specified criteria similar to those that qualify domestic banks for the statutory exemption.

With respect to private companies and (to a far lesser extent) non-profits, accommodative loans, such as mortgage relocation loans, are common, and can be expected to continue, except in cases where local laws regulate such loans, as they do for non-profits in many states.

In the absence of SEC guidance, several questions have arisen regarding what loans are permitted and what are not. In October 2002, a consensus of 25 law firms expressed their views in writing that certain activities would be permissible under §402. In expressing this consensus, the law firms have pointed out that in their view, the transaction in order to be prohibited must take the form of a loan rather than a mere extension of credit and that the loan will not be considered a personal loan if the primary purpose of the loan is to advance the business of the company. Similarly, these law firms are of the view that where an extension of credit is made in the ordinary course of business primarily for company purposes, but involves a limited ancillary personal credit, it should not be prohibited under Sarbanes-Oxley. Thus, in the opinion of the 25 law firms, the following activities should be allowed:

- Advances of cash, in accordance with company policy, to cover reimbursable business travel and expenses.
- Personal use of company credit card such as where company policy permits limited ancillary personal use (e.g. personal items included in hotel room charges) and requires settlement within a reasonable period of time.
- Personal limited use of company car where reimbursement is required to be made within a reasonable period of time.
- Advances of reimbursable relocation expenses, if treated the same as travel and similar advances.
- Stay payment of sums to employees contingent upon their remaining employed for a determined period of time with a provision requiring reimbursement if the employee terminates before the agreed date.
- Defense fees advanced by the company pursuant to charter, by-laws or indemnification agreements or D&O insurance.
- Cashless exercise of options where the broker advances the exercise price and is reimbursed out of the proceeds of the sale.

Expanded SEC Review of Disclosure Documents

Section 408 of Sarbanes-Oxley requires that the SEC review "on a regular and systematic basis" the disclosures made by reporting companies. Factors such as market capitalization, volatility, and material financial restatements are to be taken into account by the SEC in determining the frequency of review, which is to occur at least once every three years.

Analysts' Conflicts of Interest

Sarbanes-Oxley (§ 501) amends the Exchange Act to require the SEC or the market self-regulatory organizations within one year after enactment to adopt rules designed to address securities analysts' conflicts of interest.

In February, 2003, the SEC enacted Regulation Analyst Certification ("Regulation AC"), which requires that research analysts include certifications in their research reports that the views in the report accurately reflect his or her personal views.

Regulation AC also requires research analysts to disclose whether or not the analyst received any compensation for his or her recommendations or views. Regulation AC became effective on April 14, 2003.

Regulation AC also requires broker-dealers to make a record related to research analysts' public appearances. The recent Attorney General proceedings in New York further highlight the change in and leveling of the playing field in this area of such importance to investors.

The SEC's Division of Market Regulation recently published responses to a series of frequently asked questions relating to Regulation AC. In this publication, the Division of Market Regulation indicated that Regulation AC generally applies to all broker-dealers, foreign and domestic, that provide research to U.S. persons in the United States. The Division of Market Regulation noted, however, that Rule 503 provides an exemption to foreign persons not associated with a registered broker-dealer who prepare and provide research reports concerning foreign securities in accordance with Rule 15a-6(a)(2).

In addition, the SEC has approved a series of SRO research analyst rules that fulfill the requirements of Sarbanes-Oxley. For further discussion related to these rules, please see the section titled "Research Analyst Conflicts of Interest".

Job Protection for Employee Whistleblowers

Sarbanes-Oxley provides three primary provisions, which provide employee whistleblowers protection: (i) a civil cause of action for employees (§806); (ii) a felony for taking harmful action against a person, who provides information to law enforcement (§1107); and (iii) the requirement that listed companies have an audit committee, which has procedures for accepting complaints from employee whistleblowers (§301). The applicability of these provisions to foreign private issuers raises many issues, from enforcement to possible conflict with local laws, but compliance with the substance of these Sarbanes-Oxley requirements is clearly good business practice for private companies and non-profits alike.

Civil Cause of Action Under Sarbanes-Oxley (§806), a public company and its officers, employees, contractors, subcontractors, and agents are prohibited from retaliating against an employee who:

(i) provides information, causes information to be provided, or otherwise assists in an investigation regarding any conduct which the employee reasonably believes constitutes a violation of the federal mail fraud, wire fraud, bank fraud, or securities fraud statutes, any SEC rule, or any provision of federal law relating to fraud against shareholders, when the information or assistance is provided to or the investigation is conducted by a federal regulatory or law enforcement agency, any Member of Congress or Congressional committee, or a person with supervisory authority over the employee or

(ii) files, causes to be filed, testifies, participates in or otherwise assists in a proceeding filed or about to be filed (with any knowledge of the employer) relating to an alleged violation of the federal mail fraud, wire fraud, bank fraud, or securities fraud statutes, any SEC rule, or any provision of federal law relating to fraud against shareholders.

Under Sarbanes-Oxley, a person who alleges that they were discharged or discriminated in violation of Sarbanes-Oxley may seek relief by filing a complaint with the Department of Labor within 90 days of the alleged discrimination. If the Department of Labor does not issue a final decision within 180 days of the filing of the complaint, the claimant can move the action to federal court. An agency within the Department of Labor, the Occupational Safety and Health Administration ("OSHA"), has been given oversight responsibilities for whistleblower cases

under Section 806. In August 2004, OSHA published final rules establishing procedures and time frames for the handling of discrimination complaints.[23] So far, only a few of the whistleblower retaliation claims have been decided on the merits in favor of the employees.

Felony Section 1107 subjects any person (not limited to public companies or their directors and officers) who takes harmful action against a person that provides information to law enforcement officials to criminal penalties, including a fine and imprisonment for up to 10 years. This provision prohibits interference with the lawful employment or livelihood of any informant in a federal criminal proceeding.

Audit Committee Procedures As discussed above, Section 301 of Sarbanes-Oxley and Rule 10A-3 generally require listed companies to establish procedures for the (i) receipt, retention and treatment of complaints regarding accounting, internal accounting controls or auditing matters and (ii) the confidential, anonymous submission by employees regarding questionable accounting matters.

Offenses and Sanctions

Sarbanes-Oxley creates new offenses, increases existing penalties, adjusts the Federal Sentencing Guidelines as appropriate, and gives the SEC further enforcement authority.

The law also increases the statute of limitations for private securities fraud civil claims from one to two years after discovery but no later than five (from three) years after the violation.

A new crime of "Securities Fraud," likely redundant of present securities laws provisions (but probably attractive to prosecutors because of the enhanced penalties), prohibits fraud in connection with securities registered under Section 12 of the Exchange Act (§ 807).

A new obstruction of justice offense, again likely redundant of current law, is created for knowingly destroying or altering documents with the intent of impeding a federal investigation (§ 802). With a view toward Enron, the new crime prohibits document destruction "in contemplation of" any Federal investigation, versus existing law which requires an existing investigation. This new offense applies to public, private, and non-profit corporations and their directors, officers and agents alike.

[23] Available at: http://www.oalj.dol.gov/public/wblower/refrnc/69_52103.pdf

Another new obstruction of justice offense is created for destroying corporate audit or review records before five years have elapsed from the end of the period in which the audit or review was completed (§ 802). Under the SEC's rules under Section 802 of Sarbanes-Oxley, published on January 24, 2003 and under the PCAOB's rules under Section 103 of Sarbanes-Oxley, accounting firms are required to retain for seven years certain records relevant to their audits and reviews of issuers' financial statements. Under the SEC rules, accounting firms should retain workpapers and certain other documents that (i) are created, sent or received in connection with the audit and (ii) contain conclusions, opinions, analyses, or financial data related to the audit or review. Compliance is required for audits and reviews completed on or after October 31, 2003. The PCAOB's audit documentation requirements will be effective for audits of financial statements with respect to fiscal years ending on or after the later of November 15, 2004, or 30 days after the standard is approved by the SEC. This broadly conforms to minimum current record retention policies in any event.

Further, §1107 of Sarbanes-Oxley subjects any person (again, not limited to public companies or their directors and officers) who takes harmful action against a person that provides information to law enforcement officials to criminal penalties including a fine and imprisonment for up to 10 years. Specifically, this provision prohibits interference with the lawful employment or livelihood of any informant in a federal criminal proceeding.

Section 902 of Sarbanes-Oxley provides broadly that any attempt or conspiracy to commit a criminal fraud offense will be subject to the same penalties as if the attempt or conspiracy had succeeded.

As discussed above, Section 906 of Sarbanes-Oxley subjects the CEO and CFO of public companies to potential criminal penalties if they fail to properly certify their company's periodic SEC reports.

Sarbanes-Oxley makes it illegal to alter, destroy or conceal a document or other object, or attempt to do so, in order to impair the object for use in an official proceeding, or to otherwise obstruct or impede an official proceeding (§ 1102).

Sarbanes-Oxley also increases the terms and fines for various violations, and by also adjusting the Sentencing Guidelines, the more severe penalties may have pronounced effect. The new penalties provide that:

- maximum imprisonment time for mail and wire fraud is increased from five years to 20 years (§ 903).
- maximum penalties for violations of the Exchange Act are increased from 10 years to 20 years, individual fines from $1 million to $5 million, and fines for entities from $2.5 million to $25 million (§1106).
- criminal sanctions for violations of the reporting and disclosure provisions of ERISA (by anyone, not limited to public companies) are upgraded from misdemeanors to felonies, and penalties are increased from one year to 10 years; individual fines from $5,000 to $100,000, and fines for entities from $100,000 to $500,000 (§ 904).

Sarbanes-Oxley's revised penalties would have little practical effect without a corresponding adjustment of the Federal Sentencing Guidelines, so the new law required the U.S. Sentencing Commission to amend the federal sentencing guidelines within 180 days to ensure that the penalties are consistent with the Act and sufficient to deter and punish (§ 805 – obstruction and destruction of documents, fraud and misconduct; § 905 – securities fraud and ERISA; and § 1104 – securities and accounting fraud).

Sarbanes-Oxley also empowers the SEC to seek injunctive relief (§ 305), and to proceed by expedited cease-and-desist proceedings to prohibit any person who has violated the antifraud provisions of Section 10(b) of the Exchange Act from serving as an officer or director of a public company (§ 1105).

Section 803 of Sarbanes-Oxley precludes a debtor from obtaining a discharge in bankruptcy proceedings of debts incurred in violation of any federal or state securities law.

Enforcement of Sarbanes-Oxley

This section discusses recent cases involving violations of Sarbanes-Oxley.

On June 29, 2004, the SEC charged Siebel Systems, Inc. ("Siebel") with its second violation of Regulation FD and charged two of its senior executives of aiding and abetting these

violations. Regulation FD prohibits public companies from selectively disclosing material, nonpublic information to securities analysts, institutional investors, broker-dealers and others before such information is made available to the public. In addition, the SEC alleged for the first time violations of Rule 13a-15, which was adopted under Sarbanes-Oxley and requires companies to maintain disclosure controls and procedures designed to ensure that management obtains the information required to timely comply with SEC disclosure requirements. It is noteworthy that the SEC brought the Sarbanes-Oxley claim in the context of a Regulation FD complaint and not in the context of periodic reports.

Richard Scrushy, former chairman of HealthSouth Corp., was the first chief executive at a major company to be charged with violation of Sarbanes-Oxley since its enactment. A grand jury handed up 85 counts against Mr. Scrushy, including conspiracy, securities fraud, wire fraud, mail fraud, making false statements, money laundering and providing false certifications to securities regulators in violation of Sarbanes-Oxley. As discussed above, Sarbanes-Oxley imposes harsh penalties for violators.

Escrow of Extraordinary Payments

Sarbanes-Oxley (§ 1103) provides that if, while the SEC is investigating suspected violations of the U.S. securities laws by a public company or any of its directors, officers, partners, controlling partners, agents or employees, it shall appear to the SEC that it is likely that the company will make unusual payments to any of those persons, the SEC may seek a court order requiring that the payments be put in escrow until the conclusion of legal proceedings regarding the suspected violation. This may become a powerful bargaining tool with which the SEC can compel companies to settle SEC allegations.

There is nothing in the Sarbanes-Oxley Act that says this provision does not apply to foreign private issuers. However, no one knows how the U.S. courts would enforce the escrow requirement upon foreign private issuers in connection with payments to persons who are not U.S. residents.

In September 2003, the SEC filed an application in the U.S. District Court, Southern District of New York, pursuant to Section 1103 of Sarbanes-Oxley naming Vivendi Universal,

S.A. ("Vivendi") as the Respondent. The application sought an order compelling Vivendi to place in escrow any extraordinary payments that Vivendi may make to its former CEO, including payments the former CEO claimed he was owed as part of his termination agreement. On September 24, 2003, the district court ordered Vivendi to place those funds in escrow. This action represented the first resolution of a Section 1103 action. The underlying case was ultimately settled in December 2003, and, under the settlement agreement, Vivendi consented to pay a $50 million civil penalty and the former CEO relinquished any claim to his $21 million severance package. The SEC directed the disgorgement and penalties to be paid to defrauded investors pursuant to the Fair Funds provision (§ 308) of Sarbanes-Oxley.

Mandated Studies

The new law sets the stage for the next round of securities and corporate legislation by authorizing studies into the consolidation of accounting firms, the role and operations of credit rating agencies, financial statement-related enforcement action experience, and the role of investment banks and financial advisors in the manipulation of earnings and the misstatement of financials by public companies.[24]

Additional SEC Authority

Sarbanes-Oxley also gives the SEC additional authority in several areas considered necessary to accomplish the purposes of the new law. These include the SEC's being authorized to recognize accounting principles as being within GAAP where they are established by a "standard setting body," and to determine whether a particular entity qualifies as a standard setting body (§ 108), the power to censure and to bar persons from SEC practice if they are unqualified or have engaged in unethical conduct or have willfully violated the securities laws (§ 602), and the power to consider orders of state securities commissions when contemplating disciplinary action against brokers or dealers (§ 604).

[24] Several of these reports have been published including reports on: (i) credit ratings agencies; (ii) securities professionals; (iii) methods of restitution for injured investors; (iv) enforcement actions involving reporting violations and restatements of financial statements; (v) investment banks, (vi) principles based accounting and (vii) consolidation of accounting firms and ways to increase competition.

Financing

Sarbanes-Oxley significantly increases the SEC's budget to accommodate the significantly increased burden on the agency from the new regulatory, oversight and prosecutorial requirements of the law (§ 601).

The NYSE and Nasdaq Corporate Governance and Audit Committee Rules

Since the enactment of Sarbanes-Oxley, the New York Stock Exchange ("NYSE") and the Nasdaq Stock Market, Inc. ("Nasdaq") have reviewed and adopted changes to their own corporate governance standards (in the form of new listing standards). On November 4, 2003, the SEC finally approved the changes to the corporate governance listing standards of the New York Stock Exchange and Nasdaq. Due to numerous requests for clarification regarding the new corporate governance rules, the NYSE proposed amendments to the NYSE corporate governance rules. On November 3, 2004, the SEC approved the clarifying amendments to the NYSE corporate governance rules. In addition, the NYSE has published Frequently Asked Questions regarding the corporate governance rules.[25]

Under the NYSE's rules, foreign private issuers can generally follow home country practices instead of the NYSE's rules. Foreign private issuers, however, are required to comply with the portions of the rules that implement Rule 10A-3 (described above) and the CEO notification requirements (as described below). In addition, the NYSE rules require foreign private issuers to disclose any significant ways in which their corporate governance practices differ from those followed by domestic companies listed on the NYSE. Foreign private issuers are also required to provide annual and interim written affirmations to the NYSE.

Nasdaq's rules apply to foreign private issuers. However, Nasdaq may grant exemptions from the corporate governance standards to foreign private issuers, but its authority does not apply to the extent that such exemption would be contrary to the federal securities laws.

[25] Available at http://www.nyse.com/pdfs/section303Afaqs.pdf.

The following outlines the more significant of NYSE's and Nasdaq's rules, including the rules relating to independent directors, audit committee composition requirements, audit committee responsibilities and audit committee financial expert requirements.

NYSE Listing Standards

While foreign private issuers can generally follow home country practices under the NYSE's rules, the rules also require companies to disclose any significant ways in which their corporate governance practices differ from those followed by domestic companies listed on the NYSE. Therefore listed foreign private issuers must review their compliance with the NYSE's newly revised listing standards.

Majority of Independent Directors The NYSE's rules require listed companies to have a majority of independent directors serving on their Board of Directors.

Under the NYSE's rules, in order for a director of a NYSE-listed company to be considered "independent," the Board of Directors must affirmatively determine that the director has no material relationship with the listed company, and companies must identify which directors are independent and disclose the basis for this determination either in their annual proxy statement or, if the company does not file an annual proxy statement, in the company's annual report filed on Form 10-K.

Furthermore, the NYSE's rules, as amended in November 2004, preclude directors with the following relationships to the company from being independent.

A director who is an employee, or whose immediate family member is an executive officer of the listed company, is not independent until three years after the end of the employment relationship. The NYSE rules note that the term "executive officer" has the same meaning specified for the term "officer" in Rule 16a-1(f) under the Securities Exchange Act of 1934.

A director who receives or whose immediate family member receives more than $100,000 in direct compensation during any twelve-month period within the last three years from the listed company, other than director and committee fees and pension or other forms of

deferred compensation for prior service (provided such compensation is not contingent in any way on continued service) is not independent.

The amendments to the NYSE rules changed the substance of the independence test, relating to a director's employment or affiliation with a present or former internal or external auditor. Under the NYSE rules, as amended in November 2004, if: (a) a director or an immediate family member of a director is a current partner of the audit firm that is the company's internal or external auditor, (b) a director is a current employee of the audit firm, (c) a director has an immediate family member who is a current employee of such firm and who participates in the firm's audit, assurance or tax compliance (but not tax planning) practice or (d) a director or an immediate family member of the director was within the last years (but is no longer) a partner or employee of an audit firm and personally worked on the listed company's audit within that time, such director would not qualify as an "independent director." Domestic companies will have until their first annual meeting after June 30, 2005, to replace a director who was independent under the prior test but who is not independent under the current test.

Other categories of individuals who are precluded from the definition of independence include: (i) a director or an immediate family member of the director is, or has been within the last three years, employed as an executive officer of another company where any of the listed company's present executives serve on that other company's compensation committee and (ii) a director who is a current employee, or whose immediate family member is a current executive officer, of a company that has made payments to, or received payments from, the listed company for property or services in an amount which, in any of the last three fiscal years, exceeds the greater of $1 million, or 2% of such other company's consolidated gross revenues.

When applying the test for independence specified in provision (ii) above, both the payments and the consolidated gross revenues to be measured shall be those reported in the last completed fiscal year. The look-back provision for this test applies solely to the financial relationship between the listed company and the director or immediate family member's current employer. In addition, the NYSE specified that contributions to tax exempt organizations shall not be considered "payments" under provision (ii) above, provided that a listed company discloses in its annual proxy statement, or if the listed company does not file an annual proxy

statement, in the company's annual report on Form 10-K filed with the SEC, any such contributions made by the listed company to any tax exempt organization in which a director serves as an executive officer if, within the preceding three years, contributions in any single fiscal year exceeded the greater of $1 million, or 2% of such tax exempt organization's consolidated gross revenues.

The NYSE rules define "immediate family member" to include a person's spouse, parents, children, siblings, mothers and fathers in-law, sons and daughters-in law, brothers and sisters-in-law, and anyone (other than domestic employees) who shares such person's home. The NYSE's rules indicate that listed companies do not need to consider individuals who are no longer immediate family members as a result of separation or divorce, or those who have died or become incapacitated when applying the three-year look period referenced above. The NYSE is transitioning in these requirements. Each of the independence requirements listed above contains a three-year "look-back" period. The NYSE is phasing in these new requirements by applying only a one-year look back period for the first year after adoption of these new standards. The three-year look back period will therefore begin to apply only after November 4, 2004. For example, until November 3, 2004, a company must look back only one year when reviewing whether a director received prohibited compensation as discussed above. However, after November 4, 2004, the company must look back the full three years as required by the rule.

Independent Audit Committees The NYSE's rules also require listed companies to have an audit committee that satisfies the requirements of Section 301 of Sarbanes-Oxley and the SEC's Rule 10A-3. While listed companies that are foreign private issuers can generally follow home country practices in lieu of the NYSE's listing standards, the requirement to have an audit committee satisfying the requirements of the SEC's Rule 10A-3 applies to both domestic companies and foreign private issuers. As discussed above, the SEC's Rule 10A-3 generally requires audit committees to consist of unaffiliated directors who do not accept any consulting, advisory or other compensatory fee from the company.

In addition, the NYSE rules require listed companies (excluding foreign private issuers) to have a minimum of three audit committee members. In its commentary, the NYSE indicated that if an audit committee member serves on the audit committees of more than three public

companies, and the listed company does not limit the number of audit committees on which its audit committee members can serve, then the Board of Directors must in each case determine that such simultaneous service would not impair the member's effectiveness, and the Board must disclose this determination in its proxy statement or in the company's annual report on Form 10-K. The NYSE rules also require U.S. domestic companies to have a charter which specifies the committee's purpose, states the duties and responsibilities of the audit committee and indicates that the audit committee will conduct an annual evaluation of its performance. The rules specify the duties, which listed domestic companies must include their audit committee charters.

The NYSE rules also require audit committee members to satisfy the additional criteria for independence set forth in the NYSE's rules. Foreign private issuers are not required to comply with this requirement.

Relationship with the Outside Accountants Under the NYSE's rules, the audit committee must directly appoint, retain, compensate, evaluate and oversee the company's independent auditors, and the independent auditors must report directly to the audit committee. The audit committee is directly responsible for the oversight of the independent auditors, including resolving disagreements between management and the independent auditors, as required by SEC Rule 10A-3.

Whistleblower Accounting Complaints Under the NYSE's rules, each listed company must have an audit committee which has established procedures for handling employee complaints on accounting matters as required by SEC Rule 10A-3. In addition, under the NYSE's rules, each listed company's code of business conduct or code of ethics should encourage the reporting of any illegal or unethical behavior. Further, companies must ensure that employees know that the company will not permit retaliation against employees for reports made in good faith.

Independent Counsel and Outside Advisors The NYSE's rules provide that the audit committee must have the authority to engage and determine funding for the independent counsel and other advisors as required by SEC Rule 10A-3.

CEO Notification Under the NYSE's rules, CEOs must promptly notify the NYSE in writing after any executive officer becomes aware of any material non-compliance with the

applicable NYSE's rules. Foreign private issuers must comply with this notification requirement.

Audit Committee Financial Experts The NYSE's rules relating to the financial literacy of audit committee members do not apply to foreign private issuers. However, for U.S.-listed companies, each member of the audit committee must be financially literate (or become financially literate within a reasonable period of time after his or her appointment to the committee), as such qualification is determined by the Board of Directors in its business judgment. In addition, the NYSE rules require at least one member of the audit committee of U.S.-listed companies to have accounting or related financial management expertise, as the company's Board of Directors interprets such qualification in its business judgment. The NYSE also noted it does not require a listed company's audit committee to include a person who satisfies the definition of audit committee financial expert as defined in the SEC's rules (discussed above); however, a Board may presume that a person who satisfies the definition of audit committee financial expert has accounting or related financial expertise.

Code of Business Conduct and Ethics Under the NYSE's rules, listed companies are required to adopt and disclose a code of business conduct and ethics for directors, officers and employees.

The NYSE's rules require that any waiver of the code for executive officers or directors must be approved by the Board of Directors or a committee of the Board of Directors. Any waiver must be promptly disclosed to shareholders.

Listed companies must post their code of business conduct and ethics on their website, and should indicate in their annual report that their code of ethics is available on their website and that upon request any shareholder can receive this information in print.

Each code of business conduct and ethics must contain compliance standards and procedures that will facilitate the effective operation of the code.

While all listed companies can determine their own code of business conduct and ethics, all of them should address the following important topics: (i) conflicts of interest, where an executive, director or employee's private interest interferes with the interests of the corporation as a whole, (ii) misappropriation of corporate opportunities, where an executive, director or

employee takes personally any property or information belonging to the company, (iii) confidentiality of information entrusted to executives, directors and employees by the company, (iv) fair dealing with customers, suppliers, competitors and employees, (v) protection and proper use of company assets, (vi) compliance with laws, rules and regulations and (vii) encouraging the reporting of any illegal or unethical behavior.

Corporate Governance Guidelines The NYSE rules require U.S.-domestic listed companies to adopt and disclose corporate governance guidelines. Companies are required to post these guidelines and the charters of their most important committees on their website and state in their annual proxy statements, or if a company does not file an annual proxy statement, in the company's annual report on Form 10-K that the guidelines and charters are available on their website and in print to any shareholder who requests it. The following subjects must be addressed in the corporate governance guidelines: (i) director qualification standards; (ii) director responsibilities; (iii) director access to management and, as necessary and appropriate, independent advisors; (iv) director compensation; (v) director orientation and continuing education; (vi) management succession and (viii) an annual performance evaluation of the Board.

Independent Compensation Committee The NYSE rules also require listed companies (excluding foreign private issuers) to have compensation committees composed entirely of independent directors. The compensation committee must be directly responsible by its charter for reviewing and approving corporate objectives relating to the CEO's compensation and evaluating the CEO's performance in light of those objectives. In addition, the compensation committee must determine and approve the CEO's compensation level based on this evaluation either as a committee or together with the independent directors (as directed by the Board). The compensation committee must also make recommendations to the Board with respect to the non-CEO executive officer compensation, incentive-compensation and equity-based plans that are subject to Board approval. This committee must also produce a compensation committee report on executive officer compensation as required by the SEC to be included in the company's annual proxy statement or annual report. The compensation committee should also conduct an annual performance evaluation.

The NYSE indicated that in determining the long-term incentive component of CEO compensation, the committee should consider the company's performance and relative shareholder return, the value of similar incentive awards to CEOs at comparable companies, and the awards given to CEOs in past years. The NYSE clarified that the compensation committee is not precluded from approving awards (with or without ratification by the Board) as may be required to comply with applicable tax laws.

Independent Nominating/Corporate Governance Committee The NYSE rules also require listed companies (excluding foreign private issuers) to have a nominating/corporate governance committee composed entirely of independent directors. The nominating/corporate governance committee must be responsible as set forth in its charter for: (i) identifying individuals qualified to become Board members, consistent with criteria approved by the Board; (ii) selecting or recommending that the Board select, the director nominees for the next annual meeting of shareholders; (iii) developing and recommending to the Board a set of corporate governance guidelines applicable to the company and (iv) overseeing the evaluation of the Board and management. In addition, the nominating/corporate governance committee must conduct an annual performance evaluation of the committee.

The NYSE has clarified that if a company is legally required by contract or otherwise to provide third parties with the ability to nominate directors, the selection and nomination of such directors need not be subject to the nominating committee process. For example, companies with preferred stock rights to elect directors upon a dividend default or companies with certain shareholder agreements need not comply with the nominating committee requirement.

Written Affirmation The NYSE rules as amended in November 2004 specifically require that companies submit annual and interim written affirmations to the NYSE. These amendments carry forward the written affirmation requirement found under the existing NYSE rules. The written affirmations provide the NYSE with ongoing details of compliance or non-compliance with the NYSE's corporate governance rules. Foreign private issuers will be required to submit the annual and interim written affirmations. Listed companies must use the forms of written affirmation posted on the NYSE's website.[26]

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[26] The NYSE forms of annual and interim written affirmation are available at:

CEO Certification Under the NYSE Rules, each listed company CEO of domestic listed companies must certify to the NYSE each year that he or she is not aware of any violation by the company of the NYSE rules, qualifying to the extent necessary. This certification, including any qualifications to the certification, any CEO/CFO certifications required to be filed with the SEC regarding the quality of the company's public disclosure must be disclosed in the company's annual report to shareholders, or if the company does not prepare an annual report to shareholders, in the company's annual report on Form 10-K.

Executive Sessions The NYSE rules require non-management directors to meet at regularly scheduled executive sessions without management. The Commentary to the NYSE rules clarifies that non-management directors are all those who are not executive officers and includes directors who are not independent by virtue of a material relationship, former status or family relationship, or for any other reason.

Compliance Dates As noted above, foreign private issuers can continue to follow home country practices, except that they must comply with SEC Rule 10A-3, the CEO notification requirements, the written affirmation requirement, and the requirement, that they disclose any significant ways in which their corporate governance practices differ from those followed by domestic companies under the NYSE listing standards. Foreign private issuers are not required to submit the proposed written affirmations until after July 31, 2005.

Foreign private issuers will have until July 31, 2005 to comply with the new audit committee standards set out in Rule 10A-3, but will need to comply with CEO notification requirements and disclosure of differing corporate governance practices by the earlier of their first annual meeting after January 15, 2004 or October 31, 2004.

Under the NYSE's rules, U.S. listed companies must comply with all of the new listing standards by the earlier of the company's first annual meeting after January 15, 2004 or October 31, 2004. Companies with classified boards have an additional year to replace a director not scheduled to stand for election in 2004, unless the change would be required under SEC Rule 10A-3. Companies listing in conjunction with their initial public offering and companies that are emerging from bankruptcy or have ceased to be controlled companies will be required to have a

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http://www.nyse.com/Frameset.html?dispalyPage=/about/1045516490394.html.

majority of independent directors, independent compensation and nominating committees within 12 months of listing. With respect to the independence standard relating to a director's relationship with the audit firm, companies will have until their first annual meeting after June 30, 2005 to replace a director who was independent under the prior test but who is not independent under the current test (as discussed above).

Companies listing upon transfer from another market will generally have 12 months from the date of transfer in which to comply with any requirement to the extent the market on which they were listed did not have the same requirement.

Nasdaq Listing Standards

Majority of Independent Directors Nasdaq's rules also require companies to have a majority of independent directors. Listed companies must disclose the names of the independent directors in their annual proxy statement or, if the company does not file an annual proxy statement, in its annual report. If a company fails to have a majority of independent directors due to one vacancy, or if one director ceases to be independent due to circumstances beyond their reasonable control, then the company must regain compliance by the earlier of its next annual shareholders meeting or one year from the occurrence of the event that caused the failure to comply with the requirement. In addition, the company must provide notice to Nasdaq immediately upon learning of the event or circumstance that caused the noncompliance.

In order to qualify as an independent director under Nasdaq's rules, the director must not serve as an officer or employee of the company or any of its subsidiaries and the board of directors must determine that the person does not have a relationship with the company that could interfere with his or her exercise of independent judgment.

In particular, the following persons are not considered independent directors: (i) a director employed by the company or by any parent or subsidiary of the company within the last three years; (ii) a director who accepts or who has a family member who accepts payments in excess of $60,000 during the current fiscal year or any of the past three fiscal years, other than (a) compensation for board service, (b) payments arising solely from investments in the company's securities, (c) compensation paid to a family member who is an employee of the

company or any parent or subsidiary of the company, (d) benefits under a tax-qualified plan or non-discretionary compensation, (e) loans from a financial institution provided that the loans were made in the ordinary course of business, were made on the substantially the same terms as those prevailing at the time for comparable transactions with the general public, did not involve more than a normal degree of risk or other unfavorable factors, and were not otherwise subject to the specific disclosure requirements of Item 404 of Regulation S-K; (f) payments from a financial institution in connection with the deposit of funds or the financial institution acting in an agency capacity, provided such payments were made in the ordinary course of business, made on substantially the same terms as those prevailing at the time for comparable transactions with the general public and not otherwise subject to the disclosure requirements of Item 404 of Regulation S-K; or (f) loans permitted under Section 13(k) of the Securities Exchange Act of 1934; (iii) a director who is a family member of an individual who has been employed by the company or by any parent or subsidiary of the company as an executive officer within the past three years; (iv) a director who is, or has a family member who is, a partner, controlling shareholder or executive officer of any organization to which the company made, or from which the company received, payments for property or services that exceed 5% of the recipient's gross revenues for that year, or $200,000, whichever is more, other than certain permitted payments, in the current fiscal year or any of the past three fiscal years; (v) a director of the listed company who is, or has a family member who is, employed as an executive officer of another entity where any of the executive officers of the listed company serve on the compensation committee of such other entity, or if such relationship existed during the past three years or (vi) a director who is, or has a family member who is, a current partner of the company's outside auditor, or was a partner or employee of the company's outside auditor, and worked on the company's audit, within the past three years.

The Nasdaq rules define "family member" to include a person's spouse, parents, children and siblings, whether by blood, marriage or adoption, or anyone residing in such person's home. Nasdaq clarified that the three-year look-back periods (referenced above) commence on the date the relationship ceases. For example, a director employed by the company would not qualify as independent until three years after such employment terminates.

The Nasdaq rules generally exempt any controlled company from the requirement to have a majority of independent directors. A controlled company relying on this exemption must disclose in its annual proxy statement, or in its annual report if it does not file a proxy statement, that it is a controlled company and its basis for that determination.

Independent Audit Committees In addition, the Nasdaq rules require each Nasdaq-traded company to have an audit committee consisting of three members which: (i) meets Nasdaq's definition of "independence;" (ii) meets the criteria for independence set forth in Rule 10A-3 (subject to the exemptions provided under Rule 10A-3); and (iiii) have not participated in the preparation of the financial statements of the company or any current subsidiary of the company at any time during the past three years.

In addition, each member of the audit committee must be able to read and understand fundamental financial statements, including a company's balance sheet, income statement and cash flow statement.

Furthermore, the Nasdaq rules permit a person who does not meet Nasdaq's definition of independence but who meets the criteria for audit committee member independence under Sarbanes-Oxley and Rule 10A-3, and who is not a current officer or employee or family member of such person, to be appointed to the audit committee if the board in "exceptional and limited circumstances" determines this to be in the best interest of the company, and discloses the facts in its next annual proxy statement or annual report (if the company does not file a proxy statement). However, this director cannot serve on the audit committee for more than two years, and cannot be its chair.

Relationship with the Outside Accountants Nasdaq's rules require that audit committees comply with the requirements of Rule 10A-3, including fulfilling their responsibilities related to registered accounting firms. Therefore, the audit committee must be directly responsible for the appointment, compensation, retention and oversight of the work of the outside accounting firm. In addition, the outside accountants must report directly to the audit committee.

Whistleblower Accounting Complaints Nasdaq's rules require audit committees to comply with the audit committee whistleblower provisions mandated under Rule 10A-3. The audit committees of Nasdaq listed companies must therefore establish procedures for: (i)

retention of complaints received by the company regarding accounting, internal accounting controls, or auditing matters and (ii) the confidential, anonymous submission by employees of concerns regarding questionable accounting or auditing matters.

Independent Counsel and Outside Advisors Nasdaq's rules require that audit committees have the authority and funding to engage advisors as required by Rule 10A-3.

Notice of Non-Compliance Nasdaq's rules require listed companies to provide Nasdaq with prompt notification after an executive officer of the listed company becomes aware of any material noncompliance by the listed company with the corporate governance requirements.

Corporate Governance Certification Immediately following the company's next annual meeting after January 15, 2004, but no later than October 31, 2004, an authorized officer of the Nasdaq listed companies must provide a certification regarding compliance with the new audit committee, nominations process, executive sessions and code of conduct requirements. Foreign private issuers and Form SB filers do not have to submit this certification until July 31, 2005. The certification form is posted on Nasdaq's website, available at http://www.nasdaq.com/about/CG_Certification_Form.pdf.

Cure Period Nasdaq's rules afford a cure period for one audit committee member. Specifically, if a company fails to comply with the audit committee composition requirements because the audit committee member ceases to be independent for reasons outside the member's control, or due to a vacancy on the audit committee, upon notifying Nasdaq, the company will have up to the earlier of its next annual shareholders meeting or one year from the occurrence of the event that caused the failure to comply with the requirements.

Audit Committee Financial Experts Nasdaq has indicated that it will continue to require companies to comply with the existing Nasdaq listing requirements. Under Nasdaq's existing rules, the audit committee of each company must have at least one member with "past employment experience in finance or accounting, requisite professional certification in accounting, or any other comparable experience or background which results in the individual's financial sophistication, including being or having been a chief executive officer, chief financial officer or other senior officer with financial oversight responsibilities."

Nasdaq's commentary indicates that a director who qualifies as an audit committee financial expert under the SEC's final rules is presumed to qualify as a financially sophisticated audit committee member.

Code of Business Conduct and Ethics Nasdaq's final rules amend Rule 4350 requiring listed companies to adopt a code of conduct for all directors, officers and employees. These codes of conduct must be made available to the public. Under these rules, the code must comply with Sarbanes-Oxley and the SEC's regulations. Nasdaq's rules also require that each code of conduct provide for an enforcement mechanism that ensures the prompt and consistent enforcement of the code, protection for the persons reporting questionable behavior, clear and objective standards for compliance, and a fair process by which to determine violations.

Any waivers of the code for directors or executive officers must be approved by the Board of Directors and disclosed in a Form 8-K within five days.

Nasdaq-listed companies were required to have a complying code of ethics by May 4, 2004.

Executive Compensation Nasdaq's rules require CEO compensation to be determined, or recommended to the Board of Directors for determination, either by a majority of the independent directors or by a compensation committee comprised solely of independent directors. During the voting and deliberations, the CEO may not be present. In addition, the compensation of all other executive officers would have to be determined or recommended to the Board for determination either by a majority of the independent directors of the company, or a compensation committee comprised solely of independent directors.

If the compensation committee consists of at least three members, one director who is not independent and, who is not a current officer or employee or family member of such person, can be appointed to the compensation committee, if the Board in "exceptional and limited circumstances" determines this to be in the best interest of the company, and discloses the facts in its next annual proxy statement or annual report (if the company does not file a proxy statement). However, the director cannot serve on the compensation committee for more than two years.

The Nasdaq rules generally exempt any controlled company from the compensation committee requirements. A controlled company relying on this exemption must disclose in its annual proxy statement, or in its annual report if it does not file a proxy statement, that it is a controlled company and its basis for that determination.

Director Nominations Nasdaq's rules require director nominees to either be selected or recommended for the Board's selection either by a majority of independent directors or by a nominations committee comprised solely of independent directors. If the nominations committee consists of at least three members, one director who is not independent, and who is not a current officer or employee or family member of such person, can be appointed to the nominations committee, if the Board in "exceptional and limited circumstances" determines this to be in the best interest of the company, and discloses the facts in its next annual proxy statement or annual report (if the company does not file a proxy statement). However, the director cannot serve on the nominations committee for more than two years. Each nominations committee must have a written charter or Board resolution, as applicable, which addresses the nominations process and related matters as required by the federal securities laws.

Nasdaq clarified that this rule relating to the nominations process does not apply in cases where either the right to nominate a director legally belongs to a third party. In addition, the rule does not apply if the company is subject to a binding obligation that requires director nomination structure inconsistent with these nominating rules and such obligation pre-dates the date of the approval of Nasdaq's rules.

The Nasdaq rules generally exempt any controlled company from the nomination committee requirements. A controlled company relying on this exemption must disclose in its annual proxy statement, or in its annual report if it does not file a proxy statement, that it is a controlled company and its basis for that determination.

Executive Sessions with Independent Directors Nasdaq's rules require independent directors to have regularly scheduled meetings at which only independent directors are present. All Nasdaq listed companies, including controlled companies, must comply with this requirement.

Foreign Private Issuers Must Disclose Exemptions Nasdaq's rules do not require foreign issuers to do any act that is contrary to a law, rule or regulation of any public authority exercising jurisdiction over the company or that is contrary to the generally accepted business practices in the company's home country. Nasdaq has the authority to provide exemptions to carry out this intent. Under Nasdaq's final rules, Nasdaq's authority to grant exemptions is limited. Nasdaq may grant exemptions from the corporate governance standards only to foreign private issuers and its authority does not apply to the extent that such exemptions would be contrary to the federal securities laws. Nasdaq's rules require foreign private issuers to disclose the receipt of a corporate governance exemption from Nasdaq in the company's annual report with the SEC, and at the time of the company's original listing in the United States (if such company originally lists on Nasdaq). The disclosure statement must describe the home country practice, if any, the company has taken in lieu of the particular corporate governance requirement from which it was exempted. Foreign private issuers must comply with this rule for new listings and filings made on or after January 1, 2004.

Compliance Dates Foreign private issuers and small business issuers must comply with these director independence, independent committees, independent oversight of executive compensation and director nominations and notification of noncompliance requirements by July 31, 2005. All other listed companies must comply with the requirements by the earlier of the listed company's first annual shareholders meeting after January 15, 2004, or October 31, 2004.

The limitations on Nasdaq's authority to provide exemptions to foreign private issuers would be required by July 31, 2005. However, foreign issuers must disclose the receipt of a corporate governance exemption from Nasdaq to new listings and filings made after January 1, 2004.

Companies with staggered Boards will have until the second annual meeting after January 15, 2004, but not later than December 31, 2005 to implement all the new requirements relating to Board composition (other than the audit committee requirements) if the company would be required to change a director who would not normally stand for election at an earlier annual meeting.

Companies listing for the first time in conjunction with an initial public offering can transition in the committee independence requirements. These companies must have one independent member on the audit committee at the time of listing, a majority of independent members within 90 days, and all independent members within one year after listing. Companies listing in conjunction with an initial public offering could choose not to adopt a compensation or nomination committee and would be required to meet the majority independent Board requirement within one year of listing.

Companies transferring from other markets with substantially similar requirements will have the balance of any grace period afforded by the other market to comply with Nasdaq's rules. Companies transferring from other listed markets that do not have a substantially similar requirement would be afforded one year from the date of listing on Nasdaq. Companies, including foreign private issuers, must comply with the code of ethics requirements under Nasdaq's rules by May 4, 2004.

Research Analyst Conflicts of Interest

On July 29, 2003, the SEC approved NYSE and NASD rule changes addressing research analyst conflicts of interest that fulfill the requirements of Sarbanes-Oxley (§501). First, these rules separate research analyst compensation from investment banking influence and prohibit analysts from participating in "pitches" or other communications for the purpose of soliciting investment banking business. These rules also extend quiet periods and prohibit "booster shot" research reports in and around lock-up expirations. In addition, the rules require enhanced disclosure of compensation arrangements between firms and issuers and client relationships between firms, their affiliates and issuers. Under these rules, firms must notify their customers in final reports when they are terminating research coverage of covered companies. The rules also prohibit firms from retaliating or threatening to retaliate against research analysts who publish research reports or make public appearances that may adversely affect firms' investment banking business. The rules also impose registration, qualification and continuing education requirements on research analysts.

Conclusion

Sarbanes-Oxley is an extraordinary extension of U.S. Federal law into areas where traditionally the emphasis had been on disclosure versus intra-corporate regulation. The applicability of Sarbanes-Oxley to foreign private issuers has been especially controversial, and that controversy will continue as the rules are assessed in practice by the SEC and the self-regulatory organizations.

We will keep you up to date. We are Partners for Your Business®.

Questions regarding Sarbanes-Oxley may be directed to **Robert A. McTamaney** (mctamaney@clm.com), **Robert M. Riggs** (Riggs@clm.com), or **Raphael S. Grunfeld** (grunfeld@clm.com) of our New York Office (212-732-3200). **Christina Gray** assisted in the preparation of this advisory.

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