

July 29, 2002

SARBANES-OXLEY ACT OF 2002

On July 25, 2002, the U.S. Senate and the U.S. House of Representatives each passed, by overwhelming majorities, the Sarbanes-Oxley Act of 2002, sweeping new legislation with the stated purpose of protecting investors by improving the accuracy and reliability of corporate disclosures made pursuant to the Federal securities laws. The President is expected to sign the legislation tomorrow, at which time the Act will become law.

Attached is a chart summarizing the Act's provisions. We will be issuing additional Client Bulletins that focus on various aspect of the legislation, but we thought it might be helpful to provide this summary. Certain provisions of the Act become effective immediately, while others will become effective after certain dates or after the SEC adopts final rules within time periods specified in the Act (ranging from 30 to 360 days).

The following highlights certain matters under the Act that may warrant prompt consideration.

Officer Certification. On its face, the Act contains two different provisions on officer certifications. Section 302 of the Act generally requires that, beginning 30 days from enactment, CEOs and CFOs of all public companies will be required to certify in annual and quarterly reports filed with the SEC that, to their knowledge, the filed report does not contain any untrue statement or omission of a material fact, and fairly presents the company's financial condition and results. On the other hand, section 906 of the Act, which contains the criminal penalties for officers who either "knowingly" violate the certification requirement (\$1 million fine, 10 year imprisonment, or both), or "willfully" violate the requirement (\$5 million fine, 20 year imprisonment, or both), suggests that an independent officer certification requirement may be effective immediately. Section 906 also contains different substantive standards as to the certification itself (*e.g.*, reports covered, content of certification). We are informed by Congressional staff that Senate-House conferees did not believe they were creating an independent certification requirement by section 906, but merely establishing penalties related to certification failures. Nonetheless, any public company that anticipates making a filing containing financial statements with the SEC in the near future should consider consulting with us as to whether any clarification has been provided on this aspect of the Act before making that filing.

Loans to Executives. Effective immediately, public companies cannot grant or arrange any loans to any director or executive officer or renew any existing loan arrangements with those parties, subject to limited exceptions.

Executive Bonus/Profit Recapture. Effective immediately, if a public company is required to restate its financial statements as a result of corporate misconduct, the CEO and CFO must reimburse any bonus or other incentive-compensation received for the year following the misstated financial statements, as well as forfeit any profits realized from any stock sales during the period.

Section 16 Reports. Beginning 30 days from enactment, Section 16 Form 4s for principal stockholders, directors, and senior executives disclosing any changes in stock ownership will have to be filed within two business days of a transaction.

Audit Committees Matters. In general, all audit and non-audit services provided by a public company's auditor will be required to be preapproved by the audit committee. Audit committee members also will not be able to accept consulting, advisory, or other fees from the company, and at least one member of the audit committee will be required to be a "financial expert" as the SEC is to define such term (with guidance from the Act).

Pension Blackouts. Effective 180 days after enactment, officers and directors cannot buy, sell, or transfer any stock acquired in connection with their service or employment during pension fund blackout periods, and any profits realized from such transactions will be recoverable by the public company.

Whistleblower Rights. Effective immediately, public companies and their officers, employers, and agents cannot discharge or discriminate against any employee that provides information or assists in the investigation of possible Federal securities law violations or fraud against shareholders, and employees have been given certain "whistleblower" rights in the Act.

Non-U.S. Issuers. The Act generally does not contain any exceptions from the various new substantive requirements contained in the Act for non-U.S. companies that file periodic reports with the SEC.

Statute of Limitations/Penalties. The Act extends the statute of limitations for private suits involving fraud, deceit, and manipulation claims under the Federal securities laws. It also increases monetary penalties and imprisonment terms for certain civil and criminal offenses.

We would be pleased to discuss any aspect of the Act that you or your company may be considering. For more information on the Act or to discuss any items in the attached chart, please contact your regular Sidley Austin Brown & Wood contact. Please also visit our website, www.sidley.com, where we have posted our prior Client Bulletins on corporate governance matters and related issues, and where we will post further updates on the Act and related matters.

Sarbanes-Oxley Act of 2002

Main Sponsors: Paul S. Sarbanes (D-MD) & Michael G. Oxley (R-OH)

ACCOUNTING STANDARDS AND OVERSIGHT

The Act replaces the current system of self-regulation in the accounting profession with a new body, the Public Company Accounting Oversight Board (the "Board"), to, among other things: (i) oversee the audit of public companies that are subject to the securities laws, (ii) establish audit report standards and rules, and (iii) investigate, inspect, and enforce compliance relating to registered public accounting firms ("RPAFs"), persons associated with RPAFs, and obligations and liabilities of accountants.

The Board will not be an agency or establishment of the U.S. government, but will be a non-profit entity operating under general oversight of the SEC, which will have power to review Board action, including modification and rescission of Board authority. The Board is to be organized within 270 days of the date of enactment of the Act. The Board will be required to submit an annual report to the SEC and the SEC will be required to provide a copy to the Senate Banking Committee and the House Financial Services Committee not later than 30 days after receipt. (§101)

The Board will consist of five members, requiring full-time commitment and no other employment. Members will be appointed by the SEC in consultation with the Chairman of the Federal Reserve and the Treasury Secretary for up to two five-year terms. Two Board members will be certified public accountants, but no more than two certified public accountants will be permitted to serve on the Board concurrently. Terms of office of the initial Board members (other than chairperson) will expire in annual increments, one on each of the first four anniversaries of the date of enactment of the Act. Board members will be required to be prominent individuals of integrity and reputation who have demonstrated commitment to the interests of investors and the public and an understanding of the responsibilities for and nature of financial disclosures required of issuers and obligations of accountants with respect to audit reports. Board members will be prohibited from sharing in the profits of, or receiving payments from, a public accounting firm (other than retirement plans). The initial Board will be required to be appointed within 90 days. The SEC will be authorized to remove Board members for good cause. (§101)

The Board will be empowered to register public accounting firms that prepare audit reports for issuers that are subject to the '34 Act reporting requirements or have filed a registration statement under the '33 Act (an "issuer"), and will have authority to set by rule auditing, quality control, ethics, independence and other standards. The Board will also have the authority to inspect the operations of RPAFs, investigate violations of securities laws relating to the preparation and issuance of audit reports and obligations of accountants, standards of ethics, competency, and conduct set by the profession itself and the Board's own rules, enforce compliance with the proposed legislation and the Board's own rules, professional standards, and the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants thereunder, and set the budget and manage the operations of the Board and its staff. The Board will have standard corporate powers. (§101)

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New Accountant Oversight Panel/ Establishment

Board Composition/ Membership

Duties/ Powers/ Responsibility

Beginning 180 days after SEC determination that the Board has been organized, it will be unlawful for any person that is not an RPAF to prepare or issue or participate in any audit report with respect to any issuer. Accounting firms that are not RPAFs will not be permitted to conduct audits of public companies. The form and content of applications for registration will be determined by the Board but will be required to include certain information specified in the Act, including, among other things, names of issuers for whom audit reports were prepared by such accounting firm in the previous year and for which the accounting firm expects to issue reports in the current year, annual fees received from each issuer for audit services, other accounting services, and non-audit services, a statement of quality control policies for auditing/accounting, a list of accountants associated with such accounting firm, information related to criminal, civil, or administrative actions or disciplinary proceedings against the firm, and disagreements with issuers over audit reports. Each application will be required to include a consent to cooperate with the Board in connection with any request for testimony or documents and/or investigations and a statement acknowledging that such consent is a precondition to continued registration as an RPAF. Applications to become an RPAF will be required to be processed by the Board within 45 days from receipt. RPAFs will be required to submit, at a minimum, an annual report to the Board and additional reports if so requested by the Board. Applications and annual reports will be available to the public, subject to confidentiality rules of the Board or SEC. Registration and annual fees will be assessed. (§102)

Foreign public accounting firms that prepare or furnish an audit report with respect to any issuer are covered by the Act, as will the audit workpapers of such firms. An RPAF that relies on an opinion of a foreign public accounting firm will also have obligations regarding the foreign firm's workpapers. (§106)

The Board will by rule establish such auditing and related attestation standards, such quality control standards, and such ethics standards to be used by RPAFs as required by the Act, the rules of the SEC, or as may be necessary or appropriate in the public interest or for the protection of investors. The Board will have wide latitude in the development of such standards and will be empowered to create professional groups and advisory groups of practicing accountants, experts, and representatives of interested parties to make recommendations with respect to such standards. As part of the standards to be adopted, audit workpapers and other materials necessary to report audit conclusions will be required to be maintained for 7 years, review of a "qualified person" associated with accounting firms will be required in addition to second partner review, and scope and procedures of audit testing will need to be described. (§103)

The Board will conduct a continuing program of annual inspections for those RPAFs providing audit reports for 100 or more issuers to assess the compliance of each such RPAFs and their associated persons with the Act, and the Board's and the SEC's rules or professional standards in connection with the performance of audits and issuance of audit reports, and related matters. Those providing audit reports for less than 100 issuers will be reviewed not less than once every three years. In connection with any such inspection, the Board will determine whether any violation of the Act has occurred, report such findings to the SEC, and initiate a formal investigation to determine the necessity of disciplinary action. Inspected RPAFs may provide a written response to the findings of such inspection that will be included in any such inspection report. Inspection reports will be sent to applicable state regulatory authorities and be subject to public disclosure, except that negative findings documented during review will remain confidential and undisclosed if corrected within one year. (§104)

Mandatory Registration

Auditing Quality Control

Inspections

The Board will have the authority to conduct investigations of RPAFs and associated persons and request testimony and production of documents. The Board will have the authority to bar a person from continuing to practice public accounting with an RPAF, or suspend the registration of an RPAF if the Board finds that such person or RPAF has not cooperated with an investigation by the Board. The Board will also have the authority to refer an investigation to the SEC, the Attorney General, or other applicable state and federal agencies. The Act also requires the Board to coordinate investigations with the SEC's Division of Enforcement. Any documents provided to the Board in connection with any investigation will remain confidential until presented in connection with a public proceeding, except to the extent that the Board determines to provide such documentation to another federal or state authority in connection with such investigation. Hearings held by the Board will not be public unless good cause is shown for a public hearing and the parties consent thereto. Employees of the Board will be immune to prosecution to the same extent as other federal employees. (§105)

The Act empowers the Board to impose disciplinary or remedial sanctions upon RPAFs and their associated persons who are in violation of the Act, including the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto. Sanctions for intentional, knowing, reckless, or repetitively negligent conduct include temporary suspension or permanent revocation of registration, temporary or permanent bar of a person from further association with an RPAF, limitation of activities or operations, or civil monetary penalties for each violation of not more than \$750,000 for a natural person and \$15MM for other persons. The Board will also have the authority to impose civil penalties of not more than \$100,000 for a natural person and \$2,000,000 for any other person, censure, additional professional education, or other sanctions as adopted by the Board by rule for any other violations of the securities laws or Board rules. The Act authorizes Board sanctions upon an RPAF or its supervisory personnel for failure to supervise associated persons. Disciplinary proceedings of the Board will be conducted in private unless the parties agree otherwise. Any sanctions imposed by the Board will be reported to the SEC, any appropriate state regulators, and to the public, provided that any review of such sanctions was completed. It will be unlawful for any person that has been barred from association with an issuer or an RPAF to accept association with any other RPAF or with an issuer in a financial or accounting capacity, and it will be unlawful for any RPAF to accept an association, or for an issuer to accept an association in a financial capacity, with any person that had been barred from association with an RPAF or an issuer. (§105)

The Board's budget will be subject to SEC approval. The Board's funding needs will be derived from assessments on both accounting firms and issuers. Penalties imposed by the Board will fund merit scholarships for students in accounting degree programs. FASB will be funded through assessments from issuers. (§109)

The SEC will have general oversight and enforcement authority over the Board, including prior approval of rules promulgated by the Board, the establishment of procedures for rule proposals, the authority to amend rules of the Board, the review and modification of disciplinary action taken by the Board, and the censure of the Board itself or individual members of the Board. The SEC is authorized to relieve the Board of any responsibility to enforce compliance with any provision of the legislation if it determines such action to be in the public interest. (§107)

The Act authorizes the SEC to recognize as "generally accepted" for purposes of the securities laws, any accounting principles established by a standards setting body that meets certain requirements, and the Act requires the SEC to study and report to Congress within one year of the adoption by the U.S. financial reporting system of a principles-based accounting system. (§108)

Investigations

Sanctions

Board/ FASB Funding/ Budget

SEC Oversight

Accounting Standards

AUDITOR INDEPENDENCE

The Act makes it unlawful for an RPAF and associated persons of that RPAF to perform specified non-audit services contemporaneously with an audit. Prohibited areas include: book-keeping, financial systems design/implementation, appraisal/valuation services, fairness opinions, actuarial services, internal audit outsourcing services, management functions or human resources, broker or dealer, investment adviser, or investment banking services, legal services or expert services unrelated to the audit, and any other services determined by the Board. The Act requires pre-approval by the audit committee of the issuer of non-audit services not expressly forbidden by the Act, including tax services. The Board will have authority to issue exemptions to prohibitions. (§201)

All auditing (which may include providing comfort letters and statutory audits) and non-audit services will be required to be pre-approved by the audit committee of the issuer except for de minimus exemptions. Approval of non-audit functions will be required to be disclosed in an issuer's periodic reports. The audit committee may delegate the authority to grant preapprovals to one or more members of the committee. (§202)

The Act makes it unlawful for an RPAF to provide audit services to an issuer if the lead audit partner, coordinating partner, or reviewing partner has performed audit services for that issuer in each of the 5 previous fiscal years. The RPAF performing the audit for an issuer is required to issue an audit report to the audit committee of the issuer containing all critical accounting policies/practices used, all alternative treatments of financial information within GAAP that were discussed with management, ramifications of such alternative disclosures and the treatment preferred by the RPAFs, and providing other written material between management and the accounting firm. The Act requires the Comptroller General of the General Accounting Office (GAO) to provide a report within one year of the enactment of the Act to the Senate Banking Committee and the House Financial Services Committee on potential effects of requiring the mandatory rotation of RPAFs. (§§203, 204, & 207)

The Act prohibits an RPAF from performing statutorily mandated audit services for an issuer if such issuer's CEO, CFO, comptroller, CAO, or any person serving in equivalent positions has been employed by such firm and participated in the audit of that issuer during the one-year period preceding the audit initiation date. (§206)

The authority to establish standards for auditor independence will remain vested in the SEC under the Act. The Act directs that not later than 180 days after the date of enactment of the Act, the SEC will be required to issue final regulations to carry out the foregoing proposals on auditor independence. It will be unlawful for any RPAF to prepare or issue any audit report for any issuer if the RPAF or any associated person has engaged in any prohibited activity. (§208)

The Act provides that, in supervising non-RPAFs and their associated persons, appropriate state regulatory authorities should be required to make an independent determination of the proper standards applicable to such firms, particularly taking into consideration the size and nature of the business of the accounting firms they will be supervising and the nature of the business of the clients of those firms. The Act further provides that the standards that will be applied by the Board under the Act should not be presumed to be applicable for purposes of this section for small/medium-sized non-RPAFs. (§209)

Prohibited Non-Audit Activities

Pre-Approved Requirement

Audit Partner Rotation/ Audit Reports

Audit Firm Conflicts

SEC Authority on Independence

State Authority for Standards

CORPORATE RESPONSIBILITY

The Act directs the SEC, not later than 270 days after the date of enactment of Act, to direct the national securities exchanges and securities associations to prohibit the listing of any security of an issuer that is not in compliance with the requirements of the Act pertaining to audit committees, subject to possible opportunities to cure such defects. The Act makes the audit committee of an issuer directly responsible for the appointment, compensation, and oversight of the work of any RPAF employed by the issuer to perform audit services, including resolution of disagreements between management and the auditor, and the accounting firm will be required to report directly to the audit committee. The Act requires audit committee members to be independent directors. In order to be considered independent, audit committee members will be absolutely barred from accepting consulting, advisory, or other compensatory fees from the issuer and will not be permitted to be an affiliated person of the issuer or a subsidiary. The SEC may exempt a particular relationship from the independence requirements for audit committee members. At least one member of the audit committee will be required to be a "financial expert", as such term is required to be defined under the Act by SEC, as discussed further below under Enhanced Financial Disclosures. Each audit committee will be required to establish procedures for the receipt, retention, and treatment of complaints received by the issuer regarding accounting, internal accounting controls, or auditing matters and the confidential, anonymous submission by employees of concerns regarding questionable accounting or auditing matters. Each audit committee will have the legal authority to engage independent counsel and other advisors, as it determines necessary, to carry out its duties. Each issuer will be required to provide appropriate funding, as determined by the audit committee, for payment of the RPAF and any advisors. (§301)

The Act directs that the SEC require the CEO and CFO (or equivalent) of public companies to certify in each annual or quarterly report filed with the SEC that: (i) the certifying officer has reviewed the report, (ii) based on the certifying officer's knowledge, the report does not contain any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in light of the circumstances in which such statements were made, not misleading, (iii) based on the certifying officer's knowledge, the statements fairly present in all material respects the financial condition and results of operations of the issuer as of, and for the period represented in the report, (iv) the certifying officers are responsible for establishing internal controls, have designed internal controls to ensure that they are aware of material information, have evaluated the effectiveness of such internal controls, and have presented their conclusions in such financial report, (v) the certifying officers have disclosed to the issuer's auditors and audit committee all significant deficiencies in the design or operation of the issuer's internal controls and any fraud, whether or not material, that involves management or any employees who have a role in the issuer's controls, and (vi) they have indicated in the report any significant changes in internal controls during the reporting period, including corrective actions with respect to significant deficiencies or material weaknesses. The SEC's rules on officer certification must be effective within 30 days from the date of the enactment of the Act. (§302)

The certification requirements also will apply to issuers having reincorporated or engaged in any other transaction that results in the transfer of the corporate domicile or offices of the issuer from inside the U.S. to outside the U.S. (§302)

The Act also includes the White-Collar Crime Penalty Enhancement Act of 2002, which is discussed further below. That legislation sets forth monetary and imprisonment penalties for failures related to certification (criminal penalties). (§906)

The Act also provides elsewhere that it is the sense of the Senate that the federal income tax returns of a corporation should be signed by the corporation's CEO. (§1001)

Audit Committee Matters

Officer Certification

The Act makes it unlawful for any officer or director or any other person acting under their direction, to take any action to fraudulently influence, coerce, manipulate or mislead any independent public or certified accountant engaged in an audit of the financial statements of the issuer for the purpose of rendering the financial statements materially misleading. In any civil proceeding, the SEC will have exclusive authority to enforce this section of the Act and any rules/regulations promulgated thereunder. This provision is in addition to any other remedies available. The Act directs the SEC to issue proposed rules required by this section within 90 days of enactment and final rules with 270 days of enactment. (§303)

If, as a result of misconduct, an issuer is required to prepare an accounting restatement due to material noncompliance of the issuer with any financial reporting requirement under the securities laws, the CEO and CFO will be required to reimburse the issuer for (i) any bonus or other incentive-based or equity-based compensation received during the 12-month period following the first public issuance or filing with the SEC (whichever first occurs) of the financial document embodying the financial reporting requirement that was not complied with, and (ii) any profits realized from the sale of stock during that 12-month period. The SEC will have authority to exempt any person from application of this prescription. (§304)

The Act authorizes a court to prohibit a violator of securities laws from serving as an officer or director of an issuer if the person's conduct demonstrates unfitness to serve (current standard is "substantial unfitness"). Also permits SEC to seek, and any federal court may grant, any equitable relief that may be appropriate for the benefit of investors. (§305)

The Act prohibits the purchase, sale, or transfer by directors/executive officers of an issuer during pension fund blackout periods when pension plan participants of the issuer have no access to their accounts of any equity security acquired by such director/executive officer in connection with his or her service or employment with the issuer. Blackout periods are defined for purposes of this restriction on trading as any period of more than 3 consecutive business days during which at least 50% of the issuer's plan participants are unable to conduct transactions in their accounts. Profits realized from transactions in violation of this provision will inure to and be recoverable by the issuer irrespective of the intent of the parties to the transaction. Stockholders of the issuer will have a private right of action against directors/executive officers if the issuer fails to bring action within 60 days following stockholder request.

The issuer will be required to provide notice to the directors/officers, employee plan participants, and the SEC no later than 30 days prior to any anticipated blackout period, or as soon as practicable if unforeseen events cause such blackout period. Such notice will be required to set forth the reasons for the blackout, the investments and rights affected, the duration of the blackout, and a statement directing plan participants to evaluate their current investment decisions in light of their inability to direct or diversify their assets. The issuer will also be required to provide such notice in the event that the anticipated duration of the blackout period changes. The Act directs the Secretary of Labor to provide guidance and model notices that will be in compliance with the terms of this provision. The Act also excludes certain small businesses from the requirements of this provision.

The Act imposes potential penalties against the plan administrator of up to \$100 per day, per plan participant for breaches of these notice provisions. (§306)

The Act directs the SEC to issue, within 180 days of enactment of the Act, minimum standards of professional conduct for attorneys appearing and practicing before the SEC that will require attorneys to report evidence of a material violation of the securities laws or breach of fiduciary duty by a company to such company's chief executive officer or chief legal counsel, and, if such officer does not appropriately respond to such evidence, to report such evidence to the audit committee of the board of directors or other committee comprised of directors not employed directly or indirectly by the issuer, or to the company's board of directors as a whole. (§307)

Improper Influence on Audits

Forfeiture of Bonuses/ Profits

Officer/ Director Bars and Penalties

Trading During Pension Blackout Periods

Professional Responsibility of Attorneys

The Act also provides that whenever the SEC obtains the disgorgement of funds pursuant to a judgment, settlement, or civil penalty pursuant to a breach of any of the provisions of the Act that provide for the disgorgement of profits by any person, such funds are to be deposited into a public fund for the benefit of the victims of such violation. This fund may be augmented by public or charitable gifts.

The Act also directs the SEC, within 180 days after enactment of the Act, to review and analyze all SEC enforcement actions over the five years preceding the enactment of the Act that involved actions to obtain disgorgements or civil penalties to identify areas where such proceedings may be utilized to provide for restitution for injured investors. (§308)

ENHANCED FINANCIAL DISCLOSURES

The Act requires that each financial report required to be prepared in accordance with (or reconciled to) GAAP under current law and filed with SEC reflects all material correcting adjustments that are identified by an RPAF in accordance with GAAP and the rules and regulations of the SEC. (§401)

The Act directs the SEC to issue, not later than 180 days following the enactment of the Act, final rules providing that issuers disclose in each annual and quarterly report all material off-balance sheet transactions, arrangements, obligations (including contingent obligations) and relationships of the issuer with any party that may have a material current or future effect on the financial condition, results of operations, liquidity, capital expenditures, capital resources, or significant components of revenues or expenses of the issuer. (§401)

The Act directs the SEC to issue, not later than 180 days following the enactment of the Act, final rules providing for the presentation in any periodic or other report filed with SEC, or in any other public document, of pro forma financial information in a manner that does not contain an untrue statement of a material fact or omit to state a material fact necessary in order to make the pro forma financial information, in light of the circumstances under which it is presented, not misleading, and for a reconciliation of such information with the financial conditions and results of operations of the issuer under GAAP. (§401)

The Act makes it unlawful for any issuer, directly or indirectly, to extend or maintain credit, or arrange for the extension of credit, in the form of a personal loan to or for any director or executive officer (or equivalent) of the issuer. Extensions of credit currently outstanding will not be subject to the provisions of the Act unless materially modified or renewed. Such prohibitions do not preclude any home improvement and manufactured home loans, consumer credit, or any extension of credit under an open end credit plan or charge card, or any extension of credit by a broker dealer to an employee of such broker or dealer for purposes of trading in securities, provided that such extensions of credit are made in the ordinary course of the consumer credit business of such issuer (other than an extension of credit used to purchase stock of that issuer), are of a type generally made available by such issuer to the public, and are made by such issuer on market terms or terms that are no more favorable than those offered to the general public. (§402)

The Act, effective 30 days after enactment, reduces the mandatory period for principal stockholders or executive officers and directors to disclose changes in ownership of securities or securities-based swap agreements to 2 business days after any such transaction is executed (currently 10 days after close of calendar month). The Act provides, within one year from the date of enactment of the Act, that the SEC will be required to post such filings on EDGAR one business day after the filing is made by the principal stock holder and that the issuer, if it maintains a corporate website, will be required to include the information from such filing on that website within one business day after such filing. (§403)

Funds for Investor Restitution

Accuracy of Financial Reports

Off-Balance Sheet Transactions

Pro Forma Financial Information

Loans to Executives

Changes in Stock Ownership/ Section 16 Reports

The Act directs the SEC to prescribe rules requiring inclusion of an internal control report and assessment with annual reports to stockholders. Such report must state the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting and contain an assessment of the effectiveness of such structure and procedures. The Act requires the RPAF that issues the audit report to attest to, and report on, the assessments made by management. (§404)

The Act directs the SEC to issue proposed rules within 90 days of enactment of the Act and final rules within 180 days requiring each issuer to disclose in periodic reports whether or not (and if not, why not) it has adopted a code of ethics for senior financial officers applicable to its principal financial officer, comptroller, or principal accounting officer, or persons performing similar functions. The SEC will be required to revise the current Form 8-K instructions to require prompt disclosure by the issuer of any change in or waiver of such code of ethics. (§406)

The Act directs the SEC to issue proposed rules within 90 days of enactment of the Act and final rules within 180 days requiring each issuer to disclose in periodic reports whether its audit committee was comprised of at least one member who is a "financial expert" (as to be defined by SEC), and if not, why not. Factors that the SEC is required to consider in defining such term will be whether such person has, through education and experience as a public accountant, auditor, or principal financial officer, comptroller, or principal accounting officer of an issuer, or from a position involving the performances of similar functions, an understanding of GAAP and financial statements, the preparation or auditing of financial statements of generally comparable issuers, the application of such principles in connection with the accounting for estimates, accruals, and reserves, experience with internal accounting controls, and an understanding of audit committee functions. (§407)

The Act requires the SEC to review disclosures made by issuers on a more regular and systematic basis (including reports filed on form 10-K). In determining the issuers that will be subject to review, the SEC is required to consider a number of factors, including (i) issuers that have had material financial restatements, (ii) issuers that experience significant volatility in their stock price, (iii) issuers with the largest market capitalization, (iv) issuers whose operations significantly impact any material sector of the economy, (v) emerging companies with disparities in price to earnings ratios, and (vi) any other considerations deemed relevant by the SEC. Under no circumstances may the SEC review an issuer less than once every three years. (§408)

The Act empowers the SEC to adopt rules to require that every issuer disclose in plain English and on a rapid and current basis information concerning material changes in the financial condition or operations of the issuer, which may include trend and qualitative information and graphic presentations. (§409)

ANALYST CONFLICTS OF INTEREST

The Act requires the SEC, or upon direction of the SEC, a registered securities association or national securities exchange, to adopt, not later than one year after enactment of the Act, rules reasonably designed to address conflicts of interest that can arise when research analysts recommend equity securities in research reports and public appearances, in order to improve the objectivity of research and provide investors with more useful and reliable information, including rules designed to keep separate the research function from the investment banking function of a broker or dealer and to prevent investment bankers from supervising research analysts or clearing their reports, to define periods during which broker-dealers participating in public securities offerings should not publish research and to establish structural safeguards to separate research personnel. (§501)

Internal Controls

Code of Ethics

Audit Committee Expertise

Enhanced Review of Periodic Disclosures

Real-Time Disclosure

Analyst Protections

The Act requires the SEC, or upon direction of the SEC, a registered securities association or national securities exchange, to adopt, not later than one year after enactment of the Act, rules requiring analysts to disclose in public appearances, and each registered broker or dealer to disclose in each research report, conflicts of interest known or that should have been known at the time of such appearance or distribution of such report, including such specific conflicts as are specified in the Act, including, among other factors, whether the analysts compensation is based on investment banking revenues. (§501)

SEC RESOURCES/ AUTHORITY

The Act authorizes appropriation of \$776MM for FY 2003 to the SEC for (i) additional compensation, salaries, and benefits (\$102.7MM), (ii) information technology, security enhancements, and recovery and mitigating activities post-September 11 (\$108.4MM), and (iii) enhanced oversight of auditors and audit services, and additional staff for fraud prevention, market regulation, and investment management (\$98MM). (§601)

The Act grants to the SEC authority to censure any person or deny any person the privilege of appearing or practicing before the SEC if that person is found, among other things, not to be qualified or to be lacking in character or integrity or to have willfully violated or aided and abetted violations of the securities laws. (§602)

The Act grants federal courts authority to prohibit persons from participating in offerings of penny stock permanently or for such shorter period as may be determined. (§603)

STUDIES/ REPORTS

The Act requires the Comptroller General of the GAO to conduct a study and submit a report to the Senate Banking Committee within one year of enactment of the Act regarding the factors that led to consolidation of public accounting firms and consequent reduction in firms capable of providing audit services to large national and international business organizations that are subject to securities laws, and the impact on capital formation and domestic and international securities markets, and proposed solutions including ways to increase competition and the number of firms capable of providing audit services to such organizations. The study/report is required to be conducted in consultation with the SEC, Justice Department, other regulatory agencies in G-7 nations comparable to the SEC, and other public/private organizations to identify problems found by businesses resulting from limited competition of accounting firms and whether federal/state regulations impede competition among public accounting firms. (§701)

The Act requires the SEC to conduct a study and submit a report to the President, Senate Banking Committee and House Financial Services Committee within 180 days after enactment of the Act on the role/function of credit rating agencies in the operation of the securities markets. (§702)

The Act requires the SEC, based on information available since January 1, 1998, to determine the number of securities professionals who have been found to have aided and abetted violations of the securities laws but who have not been sanctioned, disciplined or penalized for such violations, as well as the number of such professionals who have been primary violators of the securities laws during that period. The study will further include information with respect to the types of violations committed by aiders and abettors and primary violators, as well as the amount of disgorgement and penalties assessed by the SEC in respect of such violations. The Act requires that such report be delivered to the House Financial Services Committee and the Senate Banking Committee within 6 months of the enactment of the Act. (§703)

Disclosure

Appropriations

Appearance/ Practice Before SEC; Censure Authority

Penny Stock Bars

Comptroller General Study of Accounting Firms

Credit Ratings Agencies

Securities Laws Violators

The Act directs the SEC to review and analyze all SEC enforcement actions involving violations of SEC reporting requirements and restatements of financial statements over the past five years to identify areas most susceptible to fraudulent activity, manipulation, or inappropriate earnings management, such as revenue recognition and accounting treatment of off-balance sheet special purpose entities. The SEC will be required to submit this report to the House Financial Services Committee and Senate Banking Committee with recommendations within 180 days from enactment of the Act. (§704)

The Act requires the Comptroller General of the GAO to conduct a study on whether investment banks and financial advisors have assisted public companies in manipulating their earnings and obfuscating their true financial condition. The study is required to address specifically the role of investment banks in the collapse of Enron and Global Crossing and generally, in creating and marketing transactions that may have been designed solely to enable companies to manipulate revenue streams, obtain loans, or move liabilities off balance sheets without altering the economic and business risks by the companies. The Act directs the Comptroller General to submit its report to Congress within 180 days and include recommendations of regulatory/legislative steps to address concerns identified in the study. (§705)

CORPORATE AND CRIMINAL FRAUD

The Act includes the Corporate and Criminal Fraud Accountability Act of 2002 that provides that whoever knowingly alters, destroys, mutilates, conceals, covers up, falsifies, or makes a false entry in any record or document with the intent to impede, obstruct, or influence the investigation or administration of any matter within the jurisdiction of any department or agency of the U.S., will be fined, imprisoned for not more than 20 years, or both. (§802)

Any accountant who conducts an audit of an issuer to which the Act will apply will be required to maintain all audit or review workpapers for 5 years from the end of the fiscal period in which the audit or review was concluded. The Act directs the SEC to issue rules within 180 days relating to the retention of recent records created, sent, or received in connection with an audit or review and that contain conclusions, opinions, analyses, or financial data relating to such audit or review. Any party that knowingly and willfully violates any SEC rules relating to retention of records will be fined or imprisoned for not more than 10 years, or both. (§802)

The Act also provides elsewhere that if any person were to alter, mutilate, conceal or destroy an object with the intent to impair the availability of such object in an official proceeding or otherwise obstruct an official proceeding will be subject to fines and imprisonment for up to 20 years. (§1102)

The Act provides that debts of an individual will be nondischargeable in a bankruptcy proceeding if incurred in violation of federal or state securities laws or rules or regulations thereunder or involving common law fraud, deceit, or manipulation in connection with the purchase or sale of any security. (§803)

The Act provides that a private right of action commenced after date of enactment of legislation and that involves a claim of fraud, deceit, manipulation, or contrivance under the securities laws could be brought not later than the earlier of 2 years after discovery of the facts constituting the violation, or 5 years after such violation. Current limits are 1 year and 3 years, respectively. (§804)

The Act directs the U.S. Sentencing Commission to review the sentencing guidelines applicable to obstruction of justice, evidence destruction, white collar criminal offenses, and accounting and securities fraud. The U.S. Sentencing Commission will be requested to promulgate guidelines as soon as possible but no later than 180 days following the enactment of the Act. (§§805, 905, & 1104)

Enforcement Actions

Investment Banks

Criminal Penalties for Altering Documents

Destruction of Corporate Audit Records

Debts Nondischargeable if Incurred in Violation of Securities Fraud Laws

Statute of Limitations for Fraud

Federal Sentencing Guidelines

The Act prohibits public companies, and officers, employers, contractors, and agents thereof from discharging, demoting, suspending, threatening, harassing or discriminating against an employee because of a lawful act by that employee to provide information or assist in an investigation regarding conduct the employee reasonably believes violates federal securities law or federal law relating to fraud against shareholders, or to assist in a proceeding filed related to a violation of such laws. The Act also provides certain whistleblower rights and relief for an employee providing information that alleges discharge or other discrimination. The Act sets forth specific procedures and remedies for whistleblowers, including a right to sue in federal court for back pay, reinstatement or compensatory damages if the Labor Department did not act on such complaint within 180 days. (§806) The Act provides elsewhere that any person that knowingly retaliates against a person providing information to a government authority in an official proceeding will be subject to fines and imprisonment for up to 10 years. (§1107)

The Act provides that whoever knowingly executes, or attempts to execute, a scheme or artifice to defraud any person in connection with any security of a public issuer, or to obtain, by means of false or fraudulent pretenses, any money or property in connection with the purchase or sale of any security of a public issuer, will be fined, imprisoned not more than 25 years, or both. (§807) The Act also provides that any person found to have violated the provisions of the '34 Act will be subject to a fine of up to \$5,000,000 and 20 years in prison for a natural person, and up to \$25,000,000 in fines for entities. (§1106).

WHITE COLLAR CRIME PENALTY ENHANCEMENTS

The Act includes the White Collar Crime Penalty Enhancement Act of 2002, that will, among other things, increase the criminal penalties for, among other actions: conspiracy to defraud the U.S. to penalties equivalent to those applicable to the underlying felony for which the conspiracy was conducted; mail and wire fraud from 5 years imprisonment to 20 years; specified violations of ERISA related to defrauding pension plans from \$5,000 to \$100,000 monetary penalties and from 1 year imprisonment to 10 years. (§901-904)

The Act requires corporate officers to certify financial reports, effective upon the date of the enactment of the Act. The Act provides that each periodic report containing financial reports filed by the issuer with the SEC will be required to be accompanied by a written statement of the CEO and CFO (or equivalent thereof). The Act requires that officers certify that the periodic report fully complies with the requirements of the '34 Act and that the financial statements contained therein fairly present, in all material aspects, the financial condition and results of operations of the issuer. Any person who knowingly violates the certification requirement upon conviction will be fined not more than \$1 million or imprisoned not more than 10 years, or both. Any person who "willfully" violates the certification requirement will be fined not more than \$5 million, or imprisoned not more than 20 years, or both. Failures related to certification will be a criminal penalty. It is not clear whether this certification requirement is in addition to that referenced in §302. (§906)

The Act provides the SEC with authority to petition a federal district court for a temporary restraining order requiring the issuer to escrow funds for 45 days whenever during the course of an investigation involving possible securities law violations by an issuer or an officer, director, control person, or employees, it appears that it is likely that the issuer intends to make an extraordinary payment to any such parties. Such an order will be permitted to be entered only after notice and an opportunity to be heard. Such escrow period could be extended to no longer than combined 90 days. (§1103)

The Act will provide the SEC with authority in any cease-and-desist proceeding to issue an order prohibiting, conditionally or unconditionally, and permanently or for such shorter period, any person who has violated section 10(b) from serving as an officer or director of any issuer if the person's conduct demonstrates "unfitness" to serve as an officer or director of an issuer. (§1105)

Protection of Employees of Publicly Traded Companies Who Provide Evidence of Fraud

Criminal Penalties for Defrauding Public Shareholders

Increase in Criminal Penalties

CEO/ CFO Certification of Financial Reports

Temporary Freeze Authority for SEC

Prohibiting Persons Serving as Officers/ Directors