THE SARBANES-OXLEY ACT OF 2002

The purpose of Sarbanes-Oxley ("S-O" or the "Act") is "to protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws, and for other purposes." This paper addresses the Corporate Responsibility and Enhanced Financial Disclosure provisions of the Act that require *final* rules be implemented by January 26, 2003. Specifically, these are

Section	Title
306	Prohibition of insider trading during pension fund blackout periods
307	Rules on professional responsibility for Attorneys
401	Disclosure rules on Off-Balance Sheet transactions and Pro Forma figures
404	Management Assessment of Internal Controls
406	Code of Ethics For Senior Financial Officers
407	Disclosure of Audit Committee Financial Expert

In the discussion of each section, first is provided a synopsis of the section as provided for in the Act, followed by the discussion of the SEC's proposed rules. In each case, the SEC has proposed rules that are more expansive and require more than the law specifically provides.

SEC. 306. Insider Trades during pension fund blackout periods.

Summary under S-O: The SEC is to adopt rules to clarify the application and prevent evasion of Section 306(a) of the Act. Section 306(a) prohibits the directors and executive officers of an issuer from, directly or indirectly, purchasing, selling or otherwise acquiring or transferring any equity security of the issuer during a pension plan blackout period that prevents plan participants or beneficiaries from engaging in equity securities transactions, if the equity security was acquired in connection with the director or executive officer's service or employment as a director or executive officer.

SEC Proposed Rules: The SEC is proposing new Regulation Blackout Trading Restriction ("BTR") to clarify the scope and application of Section 306(a). Regulation BTR would clarify, and seek to prevent evasion of, Section 306(a)'s statutory trading prohibition as follows:

- Proposed Exchange Act Rule 100 would define terms used in the regulation.
- Proposed Exchange Act Rule 101 would clarify the operation of the general statutory prohibition on trading by directors and executive officers during a pension plan blackout period and set forth exceptions to the prohibition.
- Proposed Exchange Act Rule 102 would set forth exceptions to the definition of "blackout period."
- Proposed Exchange Act Rule 103 would clarify the operation of the general statutory private remedy for violation of Section 306(a).
- Proposed Exchange Act Rule 104 would set forth the content and delivery requirements for the notice that an issuer must provide in connection with a blackout period.

The SEC will use a number of concepts that have been developed under Section 16 of the Exchange Act. This approach provides an appropriately broad scope to the statutory trading prohibition of Section 306(a), seeks to prevent evasion of the prohibition, takes advantage of a well-established body of rules and interpretations concerning the trading activities of corporate insiders and facilitates enforcement of the trading prohibition of Section 306(a) by generally allowing reference to trading reports filed pursuant to Section 16(a) of the Exchange Act.

Since the rules regarding the BTR and related notices follow concepts in Section 16, the SEC provides specific details on:

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1. Issuers Subject to Trading Prohibition
2. Persons Subject to Trading Prohibition
3. Securities Subject to Trading Prohibition
4. Transactions Subject to Trading Prohibition
5. Blackout Period
6. Remedies
7. Notice; including addressing: (a) Notice Requirement, (b) Content of Notice, (c) Notice to Directors and Executive Officers, (d) Notice to the Commission and (e) Transition Period.

Issuer action: Implement blackout notice procedures to comply with information content, timing and recipient requirements.

SEC. 307. Rules of professional responsibility for attorneys.

Summary under S-O: The SEC is required to issue rules setting forth minimum standards of professional conduct for attorneys, including a rule requiring an attorney to report evidence of a material violation of securities law or breach of fiduciary duty or similar violation and requiring the attorney to escalate the reporting if the initial response the attorney receives is not appropriate.

SEC Proposed Rules: The formal release of proposed rules has not been issued. In a press release on November 6, 2002 the SEC stated that the rule (i) would affirmatively state that an attorney representing an issuer represents the issuer as an entity rather than the officers or others with whom the attorney interacts in the course of that representation, and that the attorney is obligated to act in the best interests of the issuer and its shareholders, (ii) would prescribe the duty of an attorney who appears or practices before the Commission in the representation of an issuer to report evidence of a "material violation" (the rule would not require an attorney to "know" that a violation has been committed, but rather "reasonably believes" that a material violation has occurred), (iii) would deal with the obligation of an attorney who has not received an appropriate response from the issuer and, in certain instances, requires or permits a "noisy withdrawal," and (iv) would set forth the specific circumstances under which an attorney is authorized to disclose confidential information related to his or her appearance and practice before the Commission in the representation of an issuer.

Many questions have been raised about the attorney-client privilege and the uniform state bar requirements to represent your client with full confidence absent much more extenuating circumstances. However, it is clear that the SEC doesn't want the executives to be able to "hide behind" the cloak of advice of counsel-and in turn have counsel be under no obligation to disclose.

Issuer action: For all lawyers, inform your clients that, while the executive and financial officers have their code of ethics and certification and investigation requirements, while audit committees have specific obligations and while auditors have pre-approval, partner rotation and other independence obligations, you too have a duty to disclose.

SEC. 401. Disclosures in periodic reports.

Summary under S-O: S-O adds Section 1 3(j) to the Securities Exchange Act of 1934, which requires the SEC to adopt final rules to require each annual and quarterly financial report required to be filed with the SEC, to disclose "all material off-balance sheet transactions, arrangements, obligations (including contingent obligations), and other relationships of the issuer with unconsolidated entities or other persons, that may have a material current or future effect on financial condition, changes in financial condition, results of operations, liquidity, capital expenditures, capital resources, or significant components of revenues or expenses."

SEC Proposed Rules: The SEC "has long recognized that there is a need for a narrative explanation of financial statements and accompanying footnotes and has developed Management's Discussion and Analysis ("MD&A") over the years to fulfill this need. The disclosure in MD&A is of paramount importance in increasing the transparency of a company's financial performance and providing investors with the disclosure necessary to evaluate a company and to make informed investment decisions. After the financial statements themselves, MD&A is generally the most important portion of a company's disclosure."

In a fairly extensive discussion of its ongoing focus on the MD&A, the SEC states that “we have focused a great deal of our attention on enhancing MD&A disclosure in a continuing effort to improve transparency and restore investor confidence.”

The proposed rules define the term "off-balance sheet arrangement" as any transaction, agreement or other contractual arrangement to which an entity that is not consolidated with the registrant is a party, under which the registrant, whether or not a party to the arrangement, has, or in the future may have:

- Any obligation under a direct or indirect guarantee or similar arrangement;
- A retained or contingent interest in assets transferred to an unconsolidated entity or similar arrangement;
- Derivatives, to the extent that the fair value thereof is not fully reflected as a liability or asset in the financial statements; or
- Any obligation or liability, including a contingent obligation or liability, to the extent that it is not fully reflected in the financial statements (excluding the footnotes thereto).

In acknowledging that the definition is slightly different from the language of the Act, the release states that this is in an effort to aid companies in disclosing off-balance sheet arrangements. Disclosure is required where the off-balance sheet arrangement "may" have a current or future material effect, and disclosure would be required, unless management determines that the occurrence of an event and the materiality of its effect is outside of the realm of reasonable possibility.

To assure that the disclosure of off-balance sheet arrangements *and other contingent liabilities* is given due respect, the disclosure:

- requires certain registrants to include tabular disclosure about contractual obligations,
- would be either tabular or textual disclosure about contingent liabilities and commitments,
- would require a registrant to present the proposed disclosure about off- balance sheet arrangements set apart in a designated section of MD&A and
- should be presented in language and a format that is clear, concise and understandable. It should not be presented in such a manner that only an investor who is also an accountant or financial expert or an expert on a particular industry would be able to fully understand it.

Issuer action: Investigate the scope of and assemble comprehensive data on off-balance sheet and contingent liability arrangements. Note that even if you do not have any special purpose entities or other investments in which your company is not majority owner, the new rules will require the disclosure and discussion of all contingent liabilities and commitments in an aggregated fashion in the MD&A.

SEC. 404. Management Assessment of Internal Controls.

Summary under S-O: The SEC is to adopt rules requiring a company's management to present an internal control report in the company's annual report containing: (1) a statement of the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting; and (2) an assessment, as of the end of the company's most recent fiscal year, of the effectiveness of the company's internal control structure and procedures for financial reporting. The company's registered public accounting firm is to attest to, and report on, management's assessment.

SEC Proposed Rules: The annual report is to include an internal control report of management that includes:

- A statement of management's responsibilities for establishing and maintaining adequate internal controls and procedures for financial reporting;
- Conclusions about the effectiveness of the company's internal controls and procedures for financial reporting based on management's evaluation of those controls and procedures in accordance with Exchange Act Rule 1 3a-1 5 or 1 5d-1 5, as of the end of the company's most recent fiscal year; 106 and
- statement that the registered public accounting firm that prepared or issued the company's audit report

relating to the financial statements included in the company's annual report has attested to, and reported on, management's evaluation of the company's internal controls and procedures for financial reporting.

The proposed amendments do not specify the exact content of the proposed management report. Management is to tailor the report to the company's circumstances.

The SEC states that "A key aspect of management's responsibility for the preparation of financial information is its responsibility to establish and maintain an internal control system." The purpose of internal controls and procedures for financial reporting is to ensure that companies have processes designed to provide reasonable assurance that:

- the company's transactions are properly authorized;
- the company's assets are safeguarded against unauthorized or improper use; and
- the company's transactions are properly recorded and reported

to permit the preparation of the registrant's financial statements in conformity with generally accepted accounting principles. The SEC believes that these objectives are embodied in the definition of the term 'internal controls' as the term is defined in AICPA's Codification of Statements on Auditing Standards (AU) Section 319 and is consistent with the Act. Accordingly, the SEC will refer to AU Section 319 to define currently internal controls and procedures for financial reporting, pending action by the Public Company Accounting Oversight Board. The proposed definition would state that the term 'internal controls and procedures for financial reporting' means controls that pertain to the preparation of financial statements for external purposes that are fairly presented in conformity with generally accepted accounting principles as addressed by the Codification of Statements on Auditing Standards §319 or any superseding definition or other literature that is issued or adopted by the Public Company Accounting Oversight Board.

The Act requires every registered public accounting firm that prepares or issues an audit report for an issuer to attest to, and report on, management's assessment of the issuer's internal controls and procedures for financial reporting. The SEC is proposing amendments to Regulation S-X, Accounting Regulation, to reference the attestation report that will be prepared by registered public accounting firms and to require a company to file the attestation in annual reports on Forms 10-K. While the Act does not require filing of the attestation report, the SEC believes that it is essential in satisfying the purposes of this provision to require a company to file both the internal control report and auditor's attestation report in its annual report.

The Act requires annual disclosure of the evaluation of the company's internal controls. A company's officers already must certify to significant changes to internal controls as required by Section 302 of the Sarbanes-Oxley Act. The SEC is proposing to require the company's management to evaluate the effectiveness of the design and operation of the company's internal controls and procedures for financial reporting, as well as its disclosure controls and procedures, with respect to each annual *and quarterly report* that it is required to file under the Exchange Act. This will "provide a basis for this quarterly disclosure about changes to the company's internal controls and procedures for financial reporting, and to create symmetry between our requirements for periodic evaluations of both the company's disclosure controls and procedures and its internal controls and procedures for financial reporting." The evaluation is to be made as of the end of the period covered by the report.

Note that the Act does not specify a deadline for the implementation of management's assessment of internal controls. However, the proposed rules for this section are included in the release that addresses Sections 406 and 407, which specifically require final rules be in place by January 26, 2003.

Issuer action: Investigate and revise/adopt internal controls to assure that transactions are properly recorded and disclosed. Consider formation of a Disclosure Committee. For calendar year reporting companies, the CEO and CFO are to prepare to investigate the disclosure controls during the first quarter and report on the findings in the 2002 annual report on Form 10-K. Issuers are to prepare for the proposed rule of reporting on the disclosure assessment in each quarterly report thereafter.

SEC. 406. Code of Ethics for Senior Financial Officers.

Summary under S-O: The SEC is to adopt rules requiring a company to disclose whether it has adopted a code of ethics for the company's senior financial officers, and if not, the reasons therefore, as well as any changes to, or waiver of any provision of, that code of ethics.

The Act defines "code of ethics" to mean such standards as are reasonably necessary to promote:

(1) Honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships;

(2) Full, fair, accurate, timely and understandable disclosure in the periodic reports required to be filed by the issuer; and

(3)Compliance with applicable governmental rules and regulations.

S-O further directs the SEC to require a company subject to the Exchange Act reporting requirements to immediately disclose on Form 8-K, or by Internet or other electronic means of dissemination, any change in, or waiver of, a provision of its code of ethics for its senior financial officers.

SEC Proposed Rules: While the Act focuses on whether or not a company has adopted a code of ethics that is applicable to its senior financial officers, the SEC states that "we believe that it is appropriate to propose rules that also apply to a company's principal executive officer. Investors not only have an interest in knowing whether a public company holds its senior financial officers to certain ethical standards, but also whether a public company holds its principal executive officer to ethical standards as well." The SEC proposes to require a company to disclose:

- Whether the company has adopted a written code of ethics that applies to the company's principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions; and

- If the company has not adopted such a code of ethics, the reasons it has not done so. The SEC also proposes to broaden the definition of the term "code of ethics" with three additional factors to mean a codification of standards that is reasonably designed to deter wrongdoing and to promote:

1. Honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships;
2. Avoidance of conflicts of interest, including disclosure to an appropriate person or persons identified in the code of any material transaction or relationship that reasonably could be expected to give rise to such a conflict;
3. Full, fair, accurate, timely, and understandable disclosure in reports and documents that a company files with, or submits to, the Commission and in other public communications made by the company;
4. Compliance with applicable governmental laws, rules and regulations;
5. The prompt internal reporting to an appropriate person or persons identified in the code of violations of the code; and
6. Accountability for adherence to the code.

The second, fifth and sixth prongs of this proposed definition supplement the requirements specified by the Act. As stated by the SEC "A comprehensive code of ethics should set forth guidelines requiring avoidance of conflicts of interests and material transactions or relationships involving potential conflicts of interests without proper approval.

Moreover, an effective code of ethics should describe the company's system for the internal reporting of code violations. The code also should state clearly the consequences for non-adherence to code provisions." A copy of the issuer's ethics code will be filed as an exhibit to its annual report.

Issuer action: Adopt code of ethics for *executive and financial* officers (as expanded by SEC). Prepare to attach the code as an exhibit to the 2002 annual report on Form 10-K and to discuss the code in the report as well as any waivers of, or changes in, provisions of the code.

SEC. 407. Disclosure of Audit Committee-Financial Expert

Summary under S-O: The SEC is required to adopt rules: (1) requiring a company to disclose whether its audit committee includes at least one member who is a financial expert; and (2) defining the term "financial expert". SEC Proposed Rules: Rules would require companies to disclose:

- The number *and names* of persons that the board of directors has determined to be the financial experts serving on the company's audit committee; and

- Whether the financial expert or experts are "independent," and if not, an explanation of why they are not. If the company does not have a financial expert serving on its audit committee, the company must disclose that fact and explain why it has no financial expert.

The Act does not specifically require disclosure of the number or names of the financial experts. The SEC states that "we believe that it is appropriate to propose these requirements."

The Act does not require disclosure of whether the financial expert is independent. The SEC proposes to require disclosure of whether the identified financial expert or experts on the audit committee are independent, and if not, an explanation of why they are not. The SEC further intends to propose rules directing the national securities exchanges and national securities association to require a company to have a *completely independent audit committee* as a condition to listing (as required under the Act by April 26, 2003).

Companies will be required to include the new disclosure in their annual report on Form 10-K, but will not be required to also include this disclosure in their quarterly reports. The SEC alerts issuers that the pending Form 8-K proposals (published this past summer) would require a company to disclose the arrival or departure of a director.

Issuer action: Determine and recruit (if necessary) the one or more Financial Experts that will be on the audit committee. Revisit and revise the audit committee charter as necessary, taking into account the Section 407 requirements as well as the requirements in Section 301 that mandate full independence, an anonymous complaint process and the authority to engage advisors (to be implemented by April 26, 2003).

Closing

As stated by the SEC in the proposal release on enhanced financial disclosure "(t)he proposed amendments are intended to increase transparency regarding the competence of the audit committee, the application of ethics codes of conduct to certain of a company's executive officers, and the adequacy of a company's internal controls and procedures for financial reporting. We anticipate that these proposals would enhance the proper functioning of the capital markets by giving investors greater insight into the inner workings of public companies. This increases the competitiveness of companies participating in the U.S. capital markets."

While the first steps of the "federalization of officers and directors duties" have just begun, we have a long way to go in achieving the transparency that the investing public, Congress and the SEC are demanding of public companies.

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