

# securitieslaw

## **SARBANES-OXLEY ACT OF 2002**

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**T**he Sarbanes-Oxley Act of 2002 (the "Act") was signed into law on July 30, 2002. The Act represents a significant expansion of federal law relating to corporate governance, disclosure, reporting and accounting requirements and increases penalties for violations. This Client Advisory summarizes some of the provisions of the Act that we believe are most likely to affect our public company clients and individual clients who may be executive officers, directors or stockholders of public companies. This is not a complete summary of the Act, which is long and complex.

### **Companies Covered by the Act**

The Act generally applies to issuers of securities that are registered under the Securities Exchange Act of 1934 (the "Exchange Act"), companies that are otherwise required to file reports under the Exchange Act, and companies that file or have filed a registration statement that is not yet effective under the Securities Act of 1933.

### **Executive Officer Certification Requirements**

The Act requires that each periodic report containing financial disclosure, such as a 10-K or 10-Q, filed under the Exchange Act be accompanied by written statements by the CEO and CFO certifying that the report complies with the requirements of the Exchange Act and that the information contained in the report fairly presents, in all material respects, the financial condition and results of operations of the issuer. The Act prescribes criminal penalties for a CEO or CFO who makes the certification with knowledge that it is incorrect. The Act also requires the SEC to adopt rules requiring CEOs and CFOs to make additional certifications in each annual and quarterly report filed by an issuer with the SEC.

### **Prohibition on Loans to Directors and Executive Officers**

Issuers are prohibited from making loans to their directors or executive officers, except in very limited circumstances.

### **Accelerated Disclosure of Insider Transactions**

Effective August 29, 2002, each executive officer, director and 10% stockholder will be required to file a Form 4 under Section 16 of the Exchange Act disclosing the insider's purchases or sales of issuer securities before the end of the second business day following the day on which the transaction occurs. Previously, the deadline for Form 4 filings was 10 days after the end of the month in which the transaction occurred. In addition, effective July 30, 2003 insiders will be required to file their Section 16 reports electronically via EDGAR, and public companies that maintain Web sites will be required to post these reports no later than the end of the business day following the day they are filed with the SEC.

### **Forfeiture by CEO and CFO of Bonuses and Profits upon Financial Statement Restatement**

If an issuer is required to prepare an accounting restatement "due to the material non-compliance by the issuer, as a result of misconduct, 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 from the issuer during the 12 month period following the first public issuance or filing with the SEC of the financial document that did not comply with the relevant financial reporting requirement and (ii) any profits realized from the sale of securities of the issuer during that same 12-month period.

### **Trading Restrictions**

Effective January 26, 2003, executive officers and directors will be prohibited from buying or selling employer stock acquired in connection with their employment during blackout periods that apply to the issuer's qualified retirement plans, and any profits derived from prohibited transactions will be recoverable by the issuer. We shortly will provide more detailed information regarding this provision in a separate Client Alert.

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## Director and Officer Disqualification

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The SEC is authorized to permanently or temporarily bar individuals from serving as officers or directors of public companies if they have violated certain provisions of the securities laws and their conduct demonstrates unfitness for such service.

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## Senior Management Code of Ethics

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Issuers will be required to disclose in their periodic reports whether or not they have adopted a code of ethics for senior financial officers (and if not, why not). Changes in or waivers of this code of ethics will be required to be promptly disclosed on Form 8-K.

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## Accuracy of Financial Reports

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Each financial report that contains financial statements, and that is required to be prepared in accordance with or reconciled to GAAP and filed with the SEC, is required to reflect all "material correcting adjustments" identified by the issuer's independent auditor.

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## Real Time Disclosure of Material Financial Information

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Each issuer will be required to disclose "on a rapid and current basis" material changes in its financial condition or operations. The Act calls for the SEC to adopt rules implementing this provision. As this provision is rather vague as written, we would hope that the SEC rules will clarify it

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## Internal Controls

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Each issuer's annual report will be required to contain an "internal control report."

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## Audit Committee Independence and Responsibilities

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Effective no later than 270 days after the enactment of the Act, Nasdaq and the stock exchanges will be required to prohibit the listing of the securities of an issuer which has audit committee members who are not "independent" (defined as being unaffiliated with the issuer and not receiving any compensatory fee from the issuer other than for service as a director). Nasdaq, the New York Stock Exchange and the American Stock Exchange already have requirements regarding audit committee member independence, so it is unclear what impact, if any, this provision of the Act will have. Audit committees will be responsible for (i) the appointment, compensation and oversight of auditors, which will report directly to the audit committee and (ii) establishing procedures for (a) addressing complaints relating to auditing issues and (b) permitting employees to anonymously submit

concerns regarding accounting or auditing matters. Audit committees will also have the authority to engage advisors and will determine compensation for auditors and advisors. Effective immediately, auditing services and any non-auditing services provided by the auditors will be required to be pre-approved by the audit committee. Also effective immediately, approval by an audit committee of any non-audit services performed by an issuer's auditor will be required to be disclosed to investors in the issuer's periodic reports.

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## Disclosure of Financial Expert

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Issuers will be required to disclose in their periodic reports whether or not their audit committee includes at least one member who is a "financial expert" (and, if not, the reasons).

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## Regulation of Audit Services

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The lead audit partner and the lead review partner assigned to an issuer audit client will be required to be rotated every five years. Accounting firms will be prohibited from providing any audit service to an issuer if there are conflicts of interest with the CEO, controller, CFO or chief accounting officers of the issuer. Accounting firms that provide auditing services for an issuer will be prohibited from also providing many non-audit services to that issuer.

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## Public Company Accounting Oversight Board

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The Act establishes a five-member Public Company Accounting Oversight Board to oversee the auditing of public companies. The Board will regulate public accounting firms that prepare audit reports for Exchange Act reporting companies.

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## Enhanced Criminal Penalties

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The Act defines a new federal felony for securities fraud, extends the statute of limitations for private law suits based on securities fraud, and defines new crimes relating to destruction of documents.

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