Special Supplement—Newsworthy Insights

Summary of the Sarbanes-Oxley Act of 2002

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Introduction

The Sarbanes-Oxley Act of 2002 ("the Act") was signed by President Bush on July 30, 2002. The Act dramatically reforms the financial/management disclosures and corporate governance/responsibility of public companies.

The Act also substantially affects how the public accounting profession will perform its function of auditing public companies. The Act includes provisions (1) to modernize and reform the oversight of the public accounting profession, (2) to improve the quality and reliability of corporate financial reporting, and (3) to strengthen the independence of auditors and public company audit committees.

The Act is intended to enhance investor confidence in the publicly disclosed information on which security investment decisions are based. In effect, the Act is intended to indirectly improve the reliability and efficiency of the nation's capital markets.

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First, the Act creates an independent accounting oversight board (1) to oversee the conduct of public accountants and (2) to strengthen auditor independence from public company management. One of the most significant ways in which the Act changes the relationship between public accountants and public company management is by limiting the scope of nonaudit services that auditors can offer their audit clients.

Second, the Act includes provisions that clearly establish the specific responsibility of public company management (1) for financial reporting and (2) for the quality of financial disclosures made by public companies. The Act requires that public company CEOs and CFOs take direct responsibility for the presentation of the material in their company's financial reports.

This discussion will summarize the major provisions of the Act. For a detailed understanding of the Act, the reader is directed to (1) the Act itself or (2) a comprehensive review of the Act, such as the ones published by CCH Incorporated or other legal reporting services.

The Act contains a number of sections that relate to the (1) corporate governance and (2) public reporting of issuers. The Act also contains several provisions that relate to (1) the public accounting profession and (2) the relationship of auditors to issuers. The next section summarizes the provisions of the Act. The following sections describe the key provisions of the Act in greater detail.

Summary of the Act

The Act amends certain provisions of the Securities Act of 1933 (the "Securities Act") and the Securities Exchange Act of 1934 (the "Exchange Act"). The Act also amends certain sections of the Investment Company Act of 1940 (the "Investment Act") and the Investment Advisors Act of 1940 (the "Advisors Act"). We may occasionally refer to that historical legislation in our discussion of the Act.

The provisions of the Act regarding corporate governance, disclosure, auditors, and related matters generally apply to "issuers." The term "issuer" means an issuer of any securities registered under the Exchange Act (1) that is required to file reports under Section 15(d) of the Exchange Act or (2) that has filed a registration statement under the Securities Act that has not yet become effective.

Some of the provisions of the Act, such as the requirement for notice of blackout periods and certain of the criminal penalties, have broader application.

1. Accounting Oversight Board – The Act creates a new Public Company Accounting Oversight Board, with broad powers over the public accounting profession and independent audit firms.
2. Auditor Independence – Auditors may no longer provide certain specified nonaudit services to their audit clients. Permitted nonaudit services must be preapproved by the issuer's audit committee. Lead audit partners must be rotated every five years.

   Auditors must report to the company audit committee regarding (1) critical accounting policies, (2) possible alternative treatments of financial information, and (3) other material written communications between the auditor and company management.

   An accounting firm may not audit an issuer if the company's CEO, CFO, controller, or chief accounting officer (1) was employed by the accounting firm and (2) participated in the audit in any capacity during the last year.
3. Board of Directors Audit Committees – The requirements for an issuer to be listed on a stock exchange or on Nasdaq listing standards must include a provision that the corporation's audit committee be directly responsible for the appointment, compensation, and oversight of the compa-

ny auditors. Also, the audit committee must be comprised only of independent directors.

4. Certification of Periodic Financial Reports – Each time the issuer files a periodic report that contains financial statements, that report must include a written statement by the CEO and CFO. That statement must certify that the report (1) complies with the Exchange Act and (2) fairly presents, in all material respects, the issuer's financial condition and results of operations. In addition, the Act empowers the SEC to issue rules requiring specified additional certifications.
5. Corporate Governance and Responsibility and Reimbursement of CEO/CFO Compensation – This provision relates to situations when an issuer restates its financial statements due to material noncompliance with financial reporting requirements as a result of misconduct. In such instances, the CEO and CFO must repay any (1) bonus, (2) other incentive-based or equity-based compensation received, or (3) profits on stock trades realized during the 12-month period after the issuance or filing of the misstated financial statements.
6. Insider Trades during Blackout Periods – Notice must be given to benefit plan participants of any "blackout periods" during which the plan participants cannot trade. The issuer directors and executive officers may not trade during the benefit plan "blackout periods." If the issuer directors or officers do trade during the blackout periods, any profits earned from the prohibited trading must be repaid to the issuer.
7. Loans to Officers and Directors – Issuers may not make any new loans, or modify any existing loans, to their officers or directors.
8. Enhanced Financial Statement Disclosures – All financial statements reported by an issuer must reflect all material correcting adjustments identified by the company's auditors. The SEC is directed to issue rules regarding (1) the disclosure of off-balance-sheet transactions and other similar matters and (2) the disclosure of pro forma financial information.
9. Issuer and Management Disclosure/Insider Transactions – SEC Form 4 is the statement of change of beneficial ownership of a company insider (as defined by the Exchange Act). The filing of Form 4 is now due within two business days after the securities trade occurred.
10. Other Issuer and Management Disclosures – The Act orders the SEC to issue rules requiring that each issuer include in its periodic reports disclosures concerning: (1) the company's internal controls and financial reporting procedures, (2) whether (a) it has adopted a code of ethics and (b) it had any changes in or waivers to its code of ethics, (3) whether its audit committee includes a "financial expert," and (4) additional information concerning material changes in its financial condition or operations (in plain English and on a real-time basis).
11. Fraud and Criminal Penalties – The Act adds or increases criminal penalties for a number of securities and corporate governance matters. The Act increases the statute of limitations for actions related to private securities laws. The Act provides that debts arising from securities fraud are not dischargeable in bankruptcy. And, the Act authorizes the SEC to seek a freeze on any payments to directors, officers, and others during an investigation of securities violations.
12. SEC Resources and Authority – The Act requires the SEC to review periodic reports on a regular basis. And the Act requires the SEC to issue rules regarding the minimum standards of professional conduct for attorneys practicing before the SEC.
13. Securities Analysts and Securities Research Reports – The Act requires the SEC to issue rules that address conflicts of interest of securities analysts.

"The Act establishes a new Public Company Accounting Oversight Board. . . ."

14. Regulatory Studies and Reports – The Act requires the SEC, the Comptroller General of the United States, and the General Accounting Office to conduct a number of studies with the consideration of possible additional legislation or regulation.
15. Fraud and Criminal Penalties/ Whistleblower Protections – The Act creates federal protection for whistleblowers. The Act protects issuer employees when they act lawfully to disclose information about fraudulent activities within their company.
16. Corporate Fraud Accountability – The Act expands the authority of the SEC to prohibit "unfit" individuals from serving as an officer or director of an issuer.

Accounting Oversight Board

The Act establishes a new Public Company Accounting Oversight Board (the "Oversight Board"). The Oversight Board will be a nonprofit corporation subject to oversight by the SEC similar to the way the SEC has oversight of self-regulatory organizations such as the stock exchanges.

The Oversight Board will be funded by fees assessed against issuers in amounts to be determined by the Oversight Board. Individual assessments will be proportionate to each issuer's relative equity market capitalization.

The Oversight Board will:

1. register public accounting firms that prepare audit reports for issuers;
2. issue rules relating to auditing, quality control, ethics, independence, and other standards relating to the preparation of audit reports for issuers;

3. conduct inspections of registered public accounting firms (1) annually for a firm that audits more than 100 public companies and (2) every three years for other firms;
4. conduct investigations and disciplinary proceedings concerning registered public accounting firms and their partners, shareholders, principals, accountants, and other professional employees;
5. perform such other duties as the Oversight Board or the SEC determines appropriate (1) to promote high professional standards and improve the quality of audit services, (2) to protect investors, or (3) to further the public interest; and
6. enforce compliance by registered public accounting firms with the Act, the Oversight Board rules, accounting professional standards, and the securities laws relating to (1) the preparation and issuance of audit reports and (2) accountants' obligations and liabilities.

"The Act contains a series of provisions intended to enhance public accounting firm auditor independence."

The Oversight Board will consist of five members appointed by the SEC; two of the members will be certified public accountants. Members will serve staggered five-year terms and will be limited to two terms. Members may not engage in any other professional or business activity during their terms. Members may not share in the profits of, or receive any payment from, any public accounting firm (except for fixed continuing payments under standard retirement arrangements, subject to conditions imposed by the SEC).

Auditor Independence

The Act contains a series of provisions intended to enhance public accounting firm auditor independence. As part of these provisions, a public accounting firm may not provide the following services to its audit clients:

1. bookkeeping or other services related to the accounting records or financial statements of the audit client;
2. financial information systems design and implementation;
3. appraisal or valuation services, fairness opinions, or contribution-in-kind reports;
4. actuarial services;
5. internal audit outsourcing services;
6. management functions or human resources;
7. broker, dealer, investment advisor, or investment banking services;
8. legal services and other expert services unrelated to the audit; or
9. any other services that the Oversight Board, by regulation, deems to be impermissible.

A public accounting firm may provide other nonaudit services not specified in the above list—but only if approved in advance by an issuer's audit committee. Preapproval is not required if:

1. the aggregate amount of such services does not exceed five percent of the total revenues paid to the auditor in the year in which the nonaudit services were provided;
2. the issuer did not recognize at the time of the auditor's engagement that the services were nonaudit services; and
3. the nonaudit services are promptly brought to the attention of, and approved by, the audit committee before completion of the audit.

Any such preapproval must be disclosed in the issuer's periodic reports filed with the SEC. The audit committee may delegate the authority to grant preapprovals to one or more of its members.

As a provision of the Act, (1) the issuer's lead or coordinating audit partner and (2) the audit partner responsible for reviewing the audit must be rotated off the audit team after five years. In addition, the public accounting firm must report the following matters to the issuer's audit committee on a timely basis:

1. all critical accounting policies and practices to be used in the audit;
2. all of the alternative treatments under GAAP of financial information that are discussed with company management, the ramifications of using such alternative treatments, and the GAAP treatment preferred by the auditor; and
3. all other material written communications between the auditor and issuer management, such as management letters and schedules of unadjusted differences.

The Act prohibits any officers or directors of an issuer, or any person acting under their direction, from taking any action to fraudulently influence, coerce, manipulate, or mislead the issuer's auditor for purposes of rendering the audited financial statements misleading. The Act grants the SEC exclusive authority to bring civil actions to enforce this provision.

Board of Directors Audit Committees

The Act directs the SEC to order the stock exchanges and Nasdaq to revise their listing requirements. These new listing

requirements involve the audit committee of the issuer's board of directors. The new listing requirements must provide that the issuer's audit committee:

1. be directly responsible for the appointment, compensation, and oversight of the company auditors—and the auditors will report directly to the audit committee;
2. be comprised solely of independent directors—to be independent, a director may not be (other than in his or her capacity as a member of the board of directors or any board committee) an affiliate of the issuer or receive any consulting, advisory, or other compensatory fee (unless the SEC determines it is appropriate to exempt a particular relationship);
3. establish procedures (1) for the receipt, retention, and treatment of complaints received by the issuer regarding accounting, internal accounting controls, or audit matters and (2) for the confidential, anonymous submission by employees of concerns regarding questionable accounting or auditing matters; and
4. have the authority (1) to engage independent counsel and other advisers and (2) to determine the funding necessary to compensate such advisers and the issuer's auditors; the issuer is obligated to provide that funding.

> *"The Act contains two separate provisions regarding the certification of periodic financial reports filed under the Exchange Act."*

Certification of Periodic Financial Reports

The Act contains two separate provisions regarding the certification of periodic financial reports filed under the Exchange Act. It is noteworthy that these provisions are also different from the SEC order of June 27, 2002. That order required certifications from issuer CEOs and CFOs of the 947 largest publicly traded companies.

In the first provision, the Act requires that each periodic report filed with the SEC that contains financial statements be "accompanied" by a written statement signed by both the CEO and the CFO. That written statement must certify that:

1. the report complies with the requirements of Section 13(a) or Section 15(d) of the Exchange Act, and
2. the information contained in the report fairly presents, in all material respects, the issuer's financial condition and results of operations.

If the issuer CEO or CFO provides the certification knowing that the report does not meet these standards, then that corporate officer is subject to (1) a fine of up to $1 million, (2) imprisonment for up to 10 years, or (3) both. A willful and knowing violation of this certification provision by the CEO or CFO is subject to (1) a fine of up to $5 million, (2) imprisonment for up to 20 years, or (3) both.

In the second provision, the Act directs the SEC to issue rules requiring the issuer CEO and CFO to certify, in each quarterly or annual report, that:

1. the corporate officer has reviewed the report;
2. based on the officer's knowledge, the report does not (a) contain any untrue statement of a material fact or (b) omit to state a material fact necessary to ensure that the statements are not misleading;
3. the signing officers (a) are responsible for establishing and maintaining internal controls, (b) have designed those internal controls to ensure that material information relating to the issuer is made known to such officers, (c) have evaluated the effectiveness of such controls as of a date within 90 days prior to the report, and (d) have presented in the report their conclusions about the effectiveness of their internal controls based on such evaluation;
4. the officers have disclosed both to the issuer's auditors and to the issuer's audit committee (a) all significant deficiencies in the design or operation of internal controls that could adversely affect the issuer's ability to (1) record, (2) process, (3) summarize, and (4) report financial data and (b) any fraud involving management or other employees who have a significant role in the issuer's internal controls;
5. the officers have identified to the issuer's auditors any material weaknesses in internal controls; and
6. the officers have indicated in the report whether there were any significant changes (a) in internal controls or (b) in other factors that could significantly affect internal controls subsequent to the date of their evaluation—including any corrective actions with regard to significant deficiencies and material weaknesses.

CEO/CFO Reimbursement of Compensation

This provision relates to an issuer that is required to restate financial statements due to the issuer's material noncompliance (which was the result of any misconduct) with any financial reporting requirement under the securities law. In such an instance, the corporation's CEO and CFO must reimburse the company for:

1. any bonus or other incentive-based or equity-based compensation received by that officer during the 12-month period following (a) the first public issuance or (b) SEC fil-

ing of the financial document subject to the accounting restatement; and

2. any profits realized by that officer from the sale of securities of the issuer during that 12-month period.

The Act grants the SEC authority to exempt any person from this reimbursement obligation.

Insider Trades Blackout Periods

The Act requires that administrators of individual account plans within the meaning of ERISA (i.e., the Employee Retirement Income Securities Act of 1974) notify affected plan participants and beneficiaries of a "blackout period." The notice must be given at least 30 days prior to the start of the blackout period.

For this purpose, a "blackout period" is any period during which the ability of plan participants or beneficiaries (1) to direct or diversify assets in their accounts or (2) to obtain loans or distributions from the plan is suspended or restricted for more than three business days.

"The Act prohibits officers and directors from engaging in transactions involving any equity security of the issuer during a blackout period."

The Act provides protection for benefit plan participants by requiring that they be provided with written notice at least 30 days before a blackout period. There are two exceptions to the 30-day notice requirement.

First, an exception is allowed in cases where a deferral of the blackout period to comply with the 30-day notice requirement would violate (1) ERISA provisions that require fiduciaries to act exclusively on behalf of participants and (2) ERISA provisions that require trustees to act prudently in their decisions regarding plan assets.

Second, an exception may be provided where the inability to provide the notice is due to unforeseeable events or circumstances beyond the reasonable control of the plan administrator.

The Act prohibits officers and directors from engaging in transactions involving any equity security of the issuer during a blackout period when at least half of the issuer's individual account plan participants are not permitted to purchase, sell, or otherwise transfer their interest in that equity security. This section applies to directors and executive officers in order to ensure that the prohibition is limited to individuals in policy-making positions.

Any profit earned by a director or officer from prohibited trading during a blackout period must be returned to the issuer. The issuer or a holder of any security of the issuer may sue to recover such profits.

Loans to Officers and Directors

The Act prohibits an issuer from (1) extending or maintaining credit, (2) arranging for the extension of credit, or (3) renewing an extension of credit in the form of a personal loan to or for any officer or director. The Act grandfathers extensions of credit maintained by an issuer as of July 30, 2002, provided there is no subsequent material modification or renewal thereof.

However, the Act exempts consumer credit, charge card, and similar credit arrangements if the arrangement (1) is made in the ordinary course of the issuer's consumer credit business, (2) is of a type generally available to the public, and (3) is on market terms or terms no more favorable than those offered to the public.

Enhanced Financial Statement Disclosures

Any report filed with the SEC that contains financial statements required to be presented in accordance with generally accepted accounting principles (GAAP) must reflect all material correcting adjustments that have been identified by the issuer's public accounting firm.

The Act directs the SEC to issue rules to ensure that each quarterly or annual report filed with the SEC disclose (1) all material off-balance-sheet transactions; (2) arrangements, obligations, or other relationships with unconsolidated entities or other persons that may have a material current or future effect on financial condition; (3) changes in financial condition; (4) results of operations; (5) liquidity; (6) capital expenditures; and (7) significant revenue and expense components.

The Act directs the SEC to issue rules regarding pro forma financial information included in any SEC filing, public disclosure, and press or other release. The new rules are intended to ensure that the pro forma financial information:

1. does not contain an untrue statement of a material fact or omit to state a material fact necessary to make the pro forma financial information (in light of the circumstances under which it is presented) not misleading and
2. is reconciled with the issuer's financial condition or results of operations prepared in accordance with GAAP.

Issuer and Management Disclosure/Insider Transactions

Exchange Act Section 16(a) requires insiders to file SEC Form 4 to report changes in beneficial ownership by the end of the second business day following the date of the securities trade

transaction. The Act allows the SEC to establish a later filing deadline if it determines that the two-business-day period is not feasible.

Within one year, Form 4 reports must (1) be filed with the SEC electronically and (2) be posted by the SEC on a publicly available Internet site. The issuer will be required to post each Form 4 on its corporate Web site, if it maintains one.

Other Issuer and Management Disclosures

The Act directs the SEC to issue rules requiring that each issuer's annual report include a statement of (1) management's responsibilities for establishing and maintaining (a) an adequate internal control structure and (b) financial reporting procedures and (2) management's assessment of the effectiveness of such structure and procedures. The issuer's auditor must attest to and report on management's assessment.

The Act directs the SEC to issue rules requiring an issuer to disclose in its periodic reports whether it has adopted a code of ethics for senior financial officers and if not, the reasons why not. The new SEC rules must require an issuer to report immediately any change in or waiver from its code of ethics.

The Act directs the SEC to issue rules requiring an issuer to disclose in its periodic reports (1) whether or not its board of directors audit committee includes at least one member who is a "financial expert" (to be defined by the SEC) and (2) if not, why not. In its definition of a "financial expert," the SEC is directed to consider whether a person, through education and experience (1) as a public accountant or auditor or (2) as a senior financial officer, has:

1. an understanding of GAAP and financial statements;
2. experience in preparing or auditing financial statements of generally comparable issuers and the application of GAAP in accounting for estimates, accruals, and reserves;
3. experience with internal accounting controls; and
4. an understanding of board of director audit committee functions.

The Act directs the SEC to issue rules requiring issuers to disclose, in plain English and on a real-time basis, additional information concerning material changes in (1) its financial condition or (2) its results of operations as necessary for the protection of investors and in the public interest.

Fraud and Criminal Penalties

A knowing alteration or destruction of records or documents with the intent of obstructing or influencing any federal investigation or bankruptcy case is punishable by a fine, imprisonment for up to 20 years, or both. Any individual who (1) corruptly alters, destroys, or conceals a record or document (or attempts to do so) with the intent to impairing its integrity or availability for use in an official proceeding or (2) otherwise obstructs, influences, or impedes an official proceeding, is subject to a fine, imprisonment for up to 20 years, or both.

"A knowing alteration or destruction of records or documents with the intent of obstructing or influencing any federal investigation or bankruptcy case is punishable by a fine, imprisonment for up to 20 years, or both."

Public accountants are required to maintain audit and review work papers for five years. The SEC is directed to issue rules regarding the maintenance of other records and papers. A knowing and willful violation of these provisions is subject to a fine, imprisonment for up to 10 years, or both.

Any individual who knowingly executes or attempts to execute a scheme (1) to defraud any person in connection with a security or (2) to obtain, by means of false or fraudulent pretenses, representations or promises, any money or property in connection with the purchase or sale of a security is subject to a fine, imprisonment for up to 25 years, or both.

Any individual who knowingly takes any action harmful to any person for providing truthful information relating to the commission or possible commission of a federal offense to a law enforcement officer is subject to a fine, imprisonment for up to 10 years, or both.

The penalty for (1) willful violations of the Exchange Act or (2) willfully and knowingly making false or misleading statements in any filing under the Exchange Act is increased. The penalty is increased from (1) a fine of up to $1 million ($2.5 million for other than natural persons) and up to 10 years in prison to (2) a fine of up to $5 million ($25 million for other than natural persons) and up to 20 years in prison.

The statute of limitations for private actions alleging claims of fraud, deceit, manipulation, or contrivance in violation of securities laws is increased (1) from one year to two years after discovery of the facts constituting the violation and (2) from three years to four years after the violation.

Any debt arising from (1) a violation of federal or state securities laws or (2) common law fraud, deceit, or manipulation in connection with the purchase or sale of a security is not dischargeable in any federal bankruptcy proceeding. The potential fines and prison terms for violations of ERISA are increased (1) from $5,000 or $100,000 and up to one year (2) to $100,000 or $500,000 and up to 10 years.

The Act authorizes the SEC to petition a federal district court for a temporary order requiring an issuer to escrow any extraordinary payments (including compensation and other payments) the SEC believes the issuer is likely to make to any director, officer, partner, control person, agent, or employee during the course of an investigation of possible federal securities law violations by the issuer or such other persons. The freeze will be for a period of 45 days but may be extended by the court for up to an additional 45 days.

SEC Resources and Authority

The Act directs the SEC to enhance its review of the periodic reports filed by issuers, with each issuer to be reviewed at least once every three years. In addition, the SEC is authorized to censure or deny an individual the privilege of appearing or practicing before the SEC if the SEC finds that the individual:

1. does not possess the requisite qualifications to represent others,
2. lacks character or integrity or has engaged in unethical or improper conduct, or
3. has willfully violated or willfully aided and abetted the violation of the securities law.

The SEC is also directed to issue rules that set forth minimum standards of professional conduct for attorneys practicing before the SEC, including rules that:

1. require an attorney to report evidence of (a) a material violation of securities law or (b) breach of fiduciary duty or similar violations by a company or any of its agents to the chief legal officer or CEO and
2. require the attorney, if the officer's response is not appropriate, to report the evidence (a) to the company's audit committee, (b) to another board committee comprised solely of independent directors, or (c) to the full board of directors.

Securities Analysts and Research Reports

The Act directs the SEC to issue rules (1) to address conflicts of interest related to recommendations of securities analysts, (2) to improve the objectivity of research, and (3) to provide investors with more useful and reliable information. The Act directs the SEC to issue rules to:

1. foster greater public confidence in securities research and protect the objectivity and independence of securities analysts;
2. define periods during which brokerage firms participating in public offerings may not publish research reports regarding issuer securities in the public offering; and
3. establish structural and institutional safeguards for brokerage firms to establish appropriate informational partitions separating analysts from review, pressure, or oversight of those whose involvement in investment banking services may bias the analyst's judgment.

The Act directs the SEC or, at its direction, a national securities association or exchange, to issue rules requiring securities analysts to disclose, in public appearances and research reports, any conflicts of interest that are known by the analyst or by the broker/dealer employing the analyst, such as:

1. debt or equity investments owned by the analyst in the subject company,
2. receipt by the analyst of any compensation from such subject company,
3. services provided to the subject company by the analyst's firm within the past year, and
4. receipt by the analyst of any compensation based on the firm's investment banking revenues earned from the subject company.

Regulatory Studies and Reports

The Act directs the SEC, the Comptroller General of the United States, and the General Accounting Office to conduct studies to consider additional legislation or regulation in the following areas:

1. adoption of principles-based accounting,
2. mandatory periodic rotation of public accounting firms,
3. efficacy of disgorgement and other remedies to compensate injured victims of securities law violations,
4. off-balance-sheet transactions and special purpose entities,
5. the consolidation among firms in the public accounting profession,
6. the role and function of credit rating agencies in the operations of the securities markets,
7. the frequency and nature of securities law violations by professionals associated with the securities markets,
8. enforcement actions for violations of securities laws, and
9. the role of investment banks and financial advisers in manipulating their earnings and obfuscating their financial condition.

Corporate Fraud Accountability

Under prior law (i.e., the Exchange Act and the Securities Act), the SEC was authorized to seek a court order barring an individual who violated the anti-fraud provisions of the securities

laws from serving as a public company officer or director. However, under prior law, that individuals' conduct must have indicated "substantial unfitness" to serve as a public company officer or director.

Under the Act, the word "substantial" is removed from the definition of "unfitness." This change lowers the standard of conduct required by the SEC to bar an individual from serving as an issuer officer or director.

In addition, the Act authorizes the SEC to impose a bar against "unfit" individuals in an administrative cease and desist proceeding. The Act also authorizes the SEC to seek, and federal courts to grant, any equitable relief that may be appropriate for the benefit of investors in any action or proceeding initiated by the SEC.

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Fraud and Criminal Penalties/Whistleblower Protections

The Act prohibits (1) the issuer or (2) any officer, employee, contractor, subcontractor or agent of the issuer from discharging, demoting, suspending, threatening, harassing, or in any other manner discriminating against an employee whistleblower in the terms and conditions of employment. The Act protects a whistleblower employee who lawfully:

1. provides information, causes to provide information, or otherwise assists in an investigation regarding conduct that the employee reasonably believes involves violations of securities laws or SEC regulations or fraud against shareholders; the information must be provided to or the investigation must be conducted by (a) a federal regulatory or law enforcement agency, (b) a member or committee of Congress, or (c) a person with supervisory authority over the employee or who otherwise is authorized by the employer to investigate misconduct or
2. files, causes to be filed, testifies, participates, or otherwise assists in any proceeding filed (or about to be filed) with respect to the foregoing.

Effective Dates of the Act

The following provisions of the Act are effective as of July 30, 2002:

1. Auditor independence.
2. Prohibition against improper audit influence.
3. Periodic financial report certifications by CEOs and CFOs.
4. CEO/CFO reimbursement to the issuer following accounting restatements.
5. Lower standard for barring directors and officers; and equitable relief.
6. Ban on personal loans to issuer officers and directors.
7. Whistleblower protections.
8. Expanded financial disclosure.
9. New and enhanced enforcement provisions.
10. Provisions affecting the SEC resources and authority.

The SEC is to appoint the Accounting Oversight Board by October 28, 2002. The SEC must determine by April 26, 2003, that the Oversight Board is duly organized and capable of performing its duties. Public accounting firms are required to be registered within 180 days after the SEC makes the public determination that the oversight is fully functional.

The following provisions of the Act are effective as of October 28, 2002: (1) code of ethics for senior financial officers and (2) the disclosure of the audit committee financial expert.

The following provisions of the Act are effective as of January 26, 2003: notices of and prohibition against insider trading during a benefit fund blackout period.

Conclusion

In the wake of massive public company audit failures, periodic report disclosure errors and omissions, and financial statement accounting restatements, Congress intended the Sarbanes-Oxley Act of 2002 to address systemic weaknesses in issuer corporate governance, in issuer/auditor relationships, and in the American capital market system. As summarized in this discussion, the Act's principal provisions include:

1. the creation of an independent accounting oversight board;
2. auditor independence provisions that restrict the nonaudit services that public accountants may provide to their audit clients;
3. a range of corporate governance and responsibility measures;
4. expanded disclosure requirements, including accelerated Exchange Act Section 16(a) Form 4 reporting by insiders;
5. mandatory disclosure by analysts of potential conflicts of interest; and
6. new penalties for fraud and other securities law violations.

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