Congress Passes New Corporate Responsibility Legislation

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On July 25, 2002, the House and Senate each approved a compromise bill on accounting reform and corporate governance. President Bush has promised to sign the bill, now called the Sarbanes-Oxley Act of 2002, into law.

As described in the attached summary, the bill includes significant and wide-ranging provisions designed to:

- enhance corporate responsibility, through new corporate governance and disclosure obligations,
- increase auditor independence and establish greater oversight of the audit process for public companies, and
- toughen the penalties for securities law fraud and other violations.

The highlights of the bill of most immediate interest to management and directors of public companies are:

- Effective immediately, the Act will prohibit personal loans to executive officers and directors. Existing loans may remain outstanding, but may not be amended or extended.
- Effective immediately, CEOs and CFOs will be required to certify each annual or quarterly report filed with the SEC. The Act imposes criminal penalties, including fines of up to $5 million and imprisonment of up to 20 years for false certifications.
- Beginning 30 days after the Act is signed, the deadline for filing Form 4's reporting changes in equity ownership will be reduced to two business days after a transaction occurs.
- The Act dramatically increases the penalties for securities law violations. Among other things, the Act requires a company's CEO and CFO to disgorge to the company any bonus, incentive-based or equity-based based compensation, and profits from the

sale of the company's securities, during the 12-months following the initial filing of financial statements that must later be restated due to material noncompliance with securities laws resulting from misconduct.

- The Act expands the role of audit committees, by requiring that the committee:

  - have direct responsibility for hiring and overseeing the work of the auditors;
  - establish procedures for the receipt and handling of anonymous submissions from employees regarding questionable accounting practices;
  - disclose in SEC reports whether the committee includes at least one member who is a "financial expert";
  - not accept consulting, advisory or other compensatory fees from the company, other than directors' fees; and
  - receive reports from the auditors regarding the company's critical accounting policies and material communications between the auditors and company management.

The Act prohibits auditing firms from providing specified types of non-audit services for their audit clients. Tax services and other non-audit services that are not expressly prohibited may continue to be provided, so long as they are pre-approved by the audit committee.

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