

SEC Release Implementing Sarbanes-Oxley Provisions

Companies will soon be making new disclosures concerning:

- Internal controls
- Ethics codes
- The “financial experts” serving on a company’s audit committee

Internal Controls

The proposed rule would require companies to include in their annual reports an internal control report with three elements:

- A statement of management’s responsibilities for establishing and maintaining adequate “internal controls and procedures for financial reporting.”
- An assessment of the effectiveness of the company’s internal controls and procedures for financial reporting based on management’s evaluation as of the end of the most recent fiscal year.
- A statement that the company’s public accounting firm has attested to and reported on management’s assertion of effectiveness.

The proposed rule would amend the currently required certifications on controls by the principal executive and financial officers to include:

- Both definitions of controls
- That the certifying officers caused the controls and procedures to be designed under their supervision
- That “material weaknesses” as well as “significant deficiencies” should be disclosed to both the audit committee and independent auditors

Audit Committee Expertise

Companies would have to disclose:

- Whether they have audit-committee members considered by the board of directors to be “financial experts”
- The names of those individuals
- Whether they are independent, and why they are not independent if that is the case

A financial expert would be defined to include all the following qualifications, acquired through education and experience as a public-company auditor, controller, principal financial or accounting officer, or equivalent.

- An understanding of GAAP, the financial statements of SEC registrants, and audit committee functions
- Experience in preparing or auditing the financial statements of a comparable company
- Experience with internal controls and procedures for financial reporting

Each board of directors would be responsible to decide whether its audit committee has one or more financial experts and that designation as a financial expert would not impose a higher degree of responsibility on an individual and that designation does not reduce the obligations of other audit-committee members or the board of directors.

Ethics Codes

- Companies would have to disclose that they have adopted an ethics code for their senior financial officers and their principal executive officer or explain why they have not.
- Defined as full and fair disclosure, compliance with applicable rules and regulations and honest and ethical conduct (including ethical handling of actual or apparent conflicts of interest between personal and professional relationships).
- The proposal also requires prompt internal reporting of violations to an “appropriate” party identified in the code and avoidance of conflicts of interest, including disclosure to “an appropriate person” identified in the code of any material transaction or relationship that might create a conflict.

Comments are due by November 29, 2002 and the requirement would apply to annual reports for fiscal years ending on or after September 15, 2003.