

ASSURANCE AND ADVISORY
BUSINESS SERVICES

AUGUST 2003



 **ERNST & YOUNG**

Quality In Everything We Do

Sarbanes-Oxley Act of 2002

The Current Landscape

Rule Updates and Business Trends



This document provides a current overview of the rules related to the Act (as of August 2003) and is not intended to include a full description of the requirements. Reference should be made to the Act and related rules issued by the Securities and Exchange Commission and the Public Company Accounting Oversight Board for a more detailed understanding of the requirements applicable to public companies. Further, we encourage the use of legal counsel for determining the applicability of the Act and related rules as well as the applicability of any future rule making.

To Our Clients and Other Friends

Prior to the Sarbanes-Oxley Act of 2002 (the Act), the pressures involved in achieving business success were already high—pressures to innovate, to increase market share, to be operationally excellent and cost competitive, and to meet earnings expectations. Following the passage of the Act, these pressures continue to mount, together with increased regulation, and a renewed focus on corporate governance practices and financial reporting integrity and transparency.

Without a doubt, Sarbanes-Oxley altered the corporate landscape and created a number of changes—and challenges—for businesses, as it has for Ernst & Young. To meet the challenges of this new environment, we see this time as an opportunity to review our own practices and to grow, strengthen, and emerge as an even better organization. We are helping our clients to do the same.

Effective governance requires keen insight, focused self-assessment and evaluation, and quick action. Ernst & Young has found that even companies who believe they have excellent standards are taking a structured look at their businesses and implementing changes in accordance with Sarbanes-Oxley. In the past year, the requirements imposed by Sarbanes-Oxley have evolved as the Securities and Exchange Commission has proposed and finalized a number of rules relating to the Act.

We have summarized in this booklet the current state of rulemaking relevant to the Act. We have also been studying what companies are reacting to, how they are reacting, and what the impact has been on their businesses. As a result, we have observed a number of trends that we believe reflect the fact that our clients, like Ernst & Young, are placing a high value on quality.

To us, **Quality in Everything We Do** requires that we be attuned and responsive to the issues that are—or should be—top-of-mind for our clients and their key stakeholders. We hope the information in this booklet is helpful as you examine your own governance principles and processes and assess your position relative to the requirements of Sarbanes-Oxley.

Ernst & Young LLP

Sarbanes-Oxley Act of 2002

Reporting:
Upgrade Disclosures

Roles:
Strengthen Corporate Governance

Conduct:
Expand Insider Accountability

What's Required?

Section 302 – Page 4

Management Certifications

- Management certifies:
 - Review of quarterly and annual reports
 - Financial statements are fairly presented and reports have no untrue statements or omission of material facts
 - Responsibility for disclosure controls and procedures and internal control over financial reporting
 - Evaluation of disclosure controls and procedures as of period end, and disclosure of any material changes in internal control during the period
 - Disclosure to auditors/audit committee if control deficiencies and/or fraud exist

Section 401 – Page 13

Off-Balance Sheet and Pro Forma Disclosures

- Enhances disclosures related to:
 - Off-balance sheet transactions
 - Pro forma/non-GAAP financial information

Section 404 – Page 6

Evaluation of Internal Controls

- Annual report to include management's assessment of the effectiveness of internal control over financial reporting
- Auditor must attest to and report on management's internal control assessment

Section 409 – Page 13

Real Time Issuer Disclosures

- "Rapid and current" disclosure of material changes in financial condition or operations

Section 204 – Page 7

Auditor Communications with Audit Committees

- Increases communications between auditor and audit committee on critical accounting policies and practices, alternative accounting treatments, and other material written communications with management

Section 301 – Page 8

Audit Committee Standards

- Makes audit committee directly responsible for the appointment, compensation, and oversight of auditors
- Limits audit committee membership to independent directors
- Requires procedures for complaints from whistleblowers and others
- Requires company to provide audit committee with funding for auditors and other advisors as audit committee deems necessary

Section 402 – Page 13

Prohibition of Executive Loans

- Prohibits personal loans to officers and directors

Section 407 – Page 13

Disclosure of Audit Committee Financial Expert

- Company must disclose whether it has a financial expert on the audit committee

Section 303 – Page 14

Improper Influence on Conduct of Audits

- Makes it unlawful for any director/officer or others acting at their direction to fraudulently influence, coerce, manipulate, or mislead any independent auditor

Section 306 – Page 9

Insider Trades During Pension Fund Blackout Periods

- Prohibits insider trades during pension fund blackout periods

Section 403 – Page 14

Accelerated Reporting of Trades by Insiders

- Requires accelerated reporting of trades by insiders

Section 406 – Page 14

Code of Ethics for Senior Financial Officers

- Requires companies to disclose whether they have a code of ethics as well as any changes in or waivers from such codes

Section 806 – Page 14

Protection for Whistleblowers

- Makes it unlawful for companies to retaliate against whistleblowers

Shaded areas indicate sections where we have provided related business trends based on our observations.

This chart provides a high level overview of the Sarbanes-Oxley Act of 2002. It summarizes the Act in six key areas and includes an executive-level view of its requirements and/or implications. The page numbers noted in each section refer to the pages within this document that contain additional detail about the current rules.

Enforcement: Increase Oversight	Penalties: Broaden Sanctions	Relationships: Heighten Auditor Independence
<p>Sections 101 & 102 – Page 15 <i>Public Company Accounting Oversight Board (PCAOB) Authority Established</i></p> <ul style="list-style-type: none"> Creates PCAOB to oversee the audit of public companies. Has the authority to establish standards for auditing, quality control, ethics, and independence for auditors of public companies who must register with the PCAOB <p>Section 104 – Page 15 <i>Inspections of Public Accounting Firms</i></p> <ul style="list-style-type: none"> PCAOB shall conduct a continuing program of inspections to assess the degree of compliance of each registered public accounting firm with professional standards <p>Section 108 – Page 15 <i>Accounting Standards</i></p> <ul style="list-style-type: none"> SEC may recognize as “generally accepted” accounting principles established by an appropriate standard-setting body (i.e., FASB) SEC must conduct a study of “principles-based” accounting standards <p>Section 109 – Page 16 <i>Funding for PCAOB/FASB</i></p> <ul style="list-style-type: none"> Issuers must pay annual fees, based upon market capitalization, to support the PCAOB and FASB <p>Section 408 – Page 16 <i>Increased SEC Reviews of Public Filings</i></p> <ul style="list-style-type: none"> Expands SEC review of 10-Ks and 10-Qs at least once every 3 years <p>Section 307 – Page 16 <i>Rules of Professional Responsibility for Attorneys</i></p> <ul style="list-style-type: none"> Requires attorneys to report evidence of a company’s material violation of securities laws or breach of fiduciary duty to the Chief Legal Counsel or CEO, and report to the audit committee if management does not respond 	<p>Section 304 – Page 16 <i>Forfeiture of Certain Bonuses and Profits</i></p> <ul style="list-style-type: none"> Requires CEO and CFO to forfeit certain bonuses received and profits realized on the sale of securities following a financial report that is later restated due to material non-compliance with securities laws, as a result of misconduct <p>Section 804 – Page 16 <i>Statute of Limitations for Securities Fraud</i></p> <ul style="list-style-type: none"> Extends statute of limitations for private securities litigation alleging fraud <p>Section 906 – Page 16 <i>Management Certifications (Criminal Provision)</i></p> <ul style="list-style-type: none"> Certification similar to Sec. 302, but with criminal penalties for officers that provide a certification “knowing” it to be untrue Management certifies periodic reports: <ul style="list-style-type: none"> Fully comply with the requirements of the Securities Exchange Act of 1934 Fairly present in all material respects the financial condition and results of operations of the issuer <p>Sections 1102 & 802 – Page 17 <i>Record Tampering or Otherwise Impeding an Official Proceeding</i></p> <p>And <i>Criminal Penalties for Altering Documents</i></p> <ul style="list-style-type: none"> Criminal penalties for corruptly altering or destroying documents or otherwise impeding an official proceeding Expands criminal penalties for whoever alters documents, including audit records, to obstruct an investigation <p>Section 105 – Page 17 <i>Investigations/Disciplining of Accountants</i></p> <ul style="list-style-type: none"> Increases penalties for accountants for failure to testify, produce documents, or cooperate with an investigation 	<p>Section 201 – Page 10 <i>Prohibition of Certain Services by Auditors</i></p> <ul style="list-style-type: none"> Prohibits auditor from providing certain non-audit services to the companies audited <p>Section 202 – Page 11 <i>Audit Committee Preapproval of All Services by Auditors</i></p> <ul style="list-style-type: none"> Requires preapproval by audit committee of all services by audit firm <p>Section 203 – Page 12 <i>Audit Partner Rotation</i></p> <ul style="list-style-type: none"> Requires lead and concurring audit partner rotation every five years <p>Section 206 – Page 12 <i>Restrictions on Company Hiring of Audit Team Members</i></p> <ul style="list-style-type: none"> Requires “cooling off” period of one year before the audit firm employee who worked on the account can be hired in certain key financial oversight positions at the issuer

Rule Updates and Business Trends

SECTION 302

Management Certifications

On August 27, 2002, as required by Section 302(a) of the Sarbanes-Oxley Act of 2002 (the Act), the SEC adopted final rules requiring a company's CEO and CFO to certify each quarterly and annual report. The officers are required to certify that the financial statements and other financial information included in the report are fairly presented in all material respects. The officers must also state that the report does not contain any untrue statement of material fact or omit to state a material fact.

In addition, the certifying officers must state that the company has established and maintained "disclosure controls and procedures" sufficient to ensure that the financial and non-financial information required to be disclosed in SEC reports is recorded, processed, summarized, and reported within the specified time periods. As part of the certification, the CEO and CFO must also indicate that they have disclosed to the auditors and audit committee of the company all significant deficiencies and material weaknesses in internal control and any fraud that involves management or other employees who have a significant role in internal control.

In its final rule implementing Section 404 of the Act, the SEC adopted amendments affecting the management certifications of periodic SEC reports required by Section 302 of the Act. The following significant amendments have been made to the management certifications required under Section 302:

- 1) Management's evaluation of disclosure controls and procedures must be performed as of the end of the fiscal reporting period (not within 90 days of the filing date as required by the previous rule).
- 2) Certifying officers must state that they are responsible for establishing and maintaining internal control over financial reporting, and such internal control has been designed to provide reasonable assurance as to the reliability of financial reporting and the preparation of financial statements in accordance with GAAP. However, these disclosures may be omitted until the company's first annual report required to contain management's Section 404 internal control report.
- 3) Certifying officers must state any change during the most recent quarter in the company's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, the company's internal control.
- 4) The Section 302 management certification must be "filed" as Exhibit 31 to the related periodic report.

Business Trends—What We Are Seeing

- Management certifications are not stand-alone events, but are integrated into the routine business performance reporting and financial reporting processes.
- CEOs are increasing their involvement in the financial reporting processes and pursuing better technologies (such as executive information and business intelligence systems) to leverage their existing systems to analyze and identify potential business and/or financial inconsistencies.
- CEOs are reinforcing the tone of high accountability, responsibility, and financial and business integrity across all levels of their organizations.
- CEOs and audit committees are becoming more engaged with their external auditors, including more extensive discussions about accounting, reporting, internal controls, and audit-related matters.
- Policies, procedures and standards, including formalized investigation, reporting and resolution, are being enhanced or developed in conjunction with the implementation of certification processes to identify and address all potential violations of an organization's ethical, professional, or financial reporting values.
- Business leaders are more involved in financial reporting processes to address the potential financial consequences of business developments in a timely manner from an accounting and reporting perspective.
- Internal audit responsibilities are shifting more toward oversight of financial integrity, including greater emphasis on the evaluation of financial-related internal controls and the reliability of financial systems.
- Executive management is linking the effectiveness of its internal controls over financial reporting to its certification under Section 302 of the Act; accordingly, many companies are moving forward with their Section 404 implementations to provide added support to their certifications.
- Representation letters are requested from all senior executives directly or indirectly involved with financial reporting processes to demonstrate the heightened focus on financial integrity and accountability.
- The parent company's management certification process and corporate governance principles are replicated and leveraged at the subsidiary level, including overseas subsidiaries.
- Disclosure committees have been formed with representation from significant business, as well as corporate (e.g., finance, internal audit, legal) units. These committees generally meet quarterly to discuss business events, transactions and/or conditions requiring disclosure in the quarterly and annual reports.

SECTION 404

Evaluation of Internal Controls

Section 404 of the Act requires management of a public company to report annually on the effectiveness of the company's internal control over financial reporting. In addition, the Act requires the company's independent auditor to attest to, and report on, management's assertion. Management's internal control report and the independent auditor's related attestation report are required to be included in the company's annual report filed with the SEC.

On June 6, 2003, the SEC published its final rule (Final 404 Rule) to implement Section 404. The Final 404 Rule applies to all public companies, except registered investment companies and issuers of asset-backed securities. For "accelerated filers" (i.e., seasoned U.S. companies with public equity float exceeding \$75 million), the requirement for management and auditor reporting on internal control over financial reporting is effective for fiscal years ending on or after June 15, 2004. For all other issuers (including smaller companies, small business issuers, companies with only registered debt and preferred securities, and foreign private issuers), the Final 404 Rule is effective for fiscal years ending on or after April 15, 2005. Originally, the SEC had proposed that internal control reporting would be effective for fiscal years ending on or after September 15, 2003. The SEC's decision to extend the transition period was, at least in part, based on its realization that internal control reporting is a significant task that companies will need substantial time and resources to implement properly. In the adopting release, the SEC acknowledged that it had originally underestimated the efforts and costs of compliance and that companies face even greater first-year implementation challenges associated with compiling documentation, implementing new processes, and training staff.

The Final 404 Rule does not require management to evaluate fully the company's internal control over financial reporting as of the end of each interim reporting period. Instead, the SEC retained the requirement that management evaluate on a quarterly basis the effectiveness of the company's disclosure controls and procedures (as defined), which include many, but not necessarily all, elements of internal control over financial reporting. However, the Final 404 Rule does require management to evaluate any change that has "materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting," whether or not the change also affected the company's disclosure controls and procedures.

Business Trends—What We Are Seeing

- The deferral of Section 404 was well received by many companies because it provided them more time to challenge and improve upon existing processes and controls, to develop and improve upon management's documentation of processes and controls, and to prepare for the independent testing required by the external auditor. For the most part, companies have not used the deferral as a reason to suspend or significantly decelerate their 404 implementation projects.
- Despite the deferral of Section 404, many companies are still considering and making investments in tools and methodology to implement Section 404. Internal resources are not always sufficient to complete the work. Third-party providers are often utilized for documentation and/or testing assistance.
- Executive management has heightened its overall awareness and involvement in the design, implementation, and monitoring of internal controls over financial reporting.
- Business units are integrated into the "404 project implementation team" and assigned responsibility for the effective design of internal controls and the evaluation of controls to verify operating effectiveness.
- Policies and procedures are requiring more attention and stronger controls over highly subjective accounting areas.
- Internal audit departments are assisting with documentation and testing required for Section 404, as well as helping to complete the current year audit plan.
- Section 404 efforts are being leveraged into more robust enterprise risk management programs that extend risk management beyond just financial reporting.
- Companies are involving their auditors on a timely basis to make sure there is agreement about significant accounts and processes.
- Audit committees are requesting periodic status briefings from management.

SECTION 204

Auditor Communications with Audit Committees

Section 204 requires increased communication between the independent auditor and the audit committee on critical accounting policies and practices, alternative accounting treatments, and other required communications with management.

The new communications with audit committees will be required for audit reports that are dated and filed on or after May 6, 2003. The final rule requires the auditor to report the following to the audit committee:

- 1) All critical accounting policies and practices to be used.
- 2) All alternative treatments within generally accepted accounting principles for policies and practices related to material items that have been discussed with management of the company, including ramifications of the use of such alternative disclosures and treatments along with the treatment preferred by the independent auditor.
- 3) Other written communications between the independent auditor and the management of the company that are material to the financial statements, such as any management letter or schedule of unadjusted differences.

Business Trends—What We Are Seeing

- The external auditor and the audit committee are engaging in more open discussions and are having more substantive, active, and direct interaction. Generally, both the frequency and length of audit committee meetings have increased.
- Additional meetings and conference calls are being scheduled, generally on a quarterly basis, to discuss financial reporting and disclosures prior to earnings releases and Form 10-Q filings.
- More frequent meetings and communications between the independent auditor and the audit committee are changing the relationship dynamics and protocols. Auditors are spending more time discussing accounting, reporting, and auditing issues directly with audit committee members and, more specifically, audit committee chairs.
- Auditors are being asked to provide more observations on the quality of financial statements, management, and the internal audit function.
- Audit committees are more focused on the approach used by auditors to obtain sufficient audit scope and coverage.
- Audit committees are asking the independent auditors to discuss in more detail their procedures for interim reviews of quarterly financial statements.

SECTION 301

Audit Committee Standards

On April 10, 2003, the SEC published its final rule to implement Section 301. The SEC rule requires the national securities exchanges and associations (the self-regulatory organizations, or SROs) to amend their listing standards to conform to at least the rule's minimum audit committee requirements. Consistent with Section 301 of the Act, Exchange Act Rule 10A-3 establishes the following minimum audit committee requirements for SRO listing standards:

- 1) Each member of the audit committee must be a member of the board of directors and otherwise be independent, as defined.
- 2) The audit committee must be directly responsible for the appointment, compensation, retention, and oversight of the work of any registered public accounting firm engaged for the purpose of preparing or issuing an audit report or performing other audit, review, or attest services for the company. Each such registered public accounting firm must report directly to the audit committee.
- 3) The audit committee must establish procedures for the receipt, retention, and treatment of complaints regarding accounting, internal controls or auditing matters, including procedures for the confidential, anonymous submission by employees of concerns about questionable accounting or auditing matters.
- 4) The audit committee must have the authority to engage independent counsel and other advisors, as it determines necessary to carry out its duties, and the company must provide appropriate funding, as determined by the audit committee, for the payment of compensation to auditors and advisors and the payment of expenses incurred by the committee.

The SEC must approve each SRO's listing standards no later than December 1, 2003. Listed companies then will be required to comply with their respective SRO's listing standards for audit committees by the date of their first annual shareholders meeting held after January 15, 2004, but by no later than October 31, 2004. Separately, under the transition provisions, listed companies that are foreign private issuers or small business issuers have until July 31, 2005, to comply with the revised SRO listing standards regarding audit committees.

Business Trends—What We Are Seeing

- Audit committee members are expanding their knowledge of the company's financial management and reporting and the role of the independent auditor, and have increased their time commitment and involvement in communicating and meeting with management and the auditors.
- Companies and audit committees are recognizing that additional education and training on accounting and auditing matters may be necessary to ensure audit committee members' understanding of financial reporting issues.
- Companies are utilizing board nominating/governance committees to evaluate the independence of all directors.
- Companies are providing anonymous hotlines as intake mechanisms for complaints and whistleblowers. Ethics officers, corporate compliance governance officers, department heads, general counsel, and objective third parties receive calls and present results to the audit committee.
- Audit committees are asking for team credentials and detail pertaining to an audit firm's quality control procedures in connection with auditor reappointment.

SECTION 306

Insider Trades During Pension Fund Blackout Periods

During a qualifying pension “blackout period” that temporarily prevents plan participants or beneficiaries from engaging in equity securities transactions through their plan accounts, Section 306 prohibits any director or officer from directly or indirectly engaging in transactions involving the company’s equity securities acquired in connection with his or her service or employment. In addition, the SEC amended Form 8-K to require U.S. public companies to report information about an impending blackout period. Special provisions apply to foreign private issuers.

On January 22, 2003, the SEC published Regulation BTR, Blackout Trading Restriction, to clarify the scope and application of Section 306. Regulation BTR became effective for blackout periods beginning on or after January 26, 2003. Section 306 amended the Employee Retirement Income Security Act of 1974 (ERISA) to require plan administrators to notify plan participants and beneficiaries of blackout periods generally at least 30 days in advance. Effective January 26, with limited exceptions, any affected participants or beneficiaries must be notified when their ability to take discretionary actions otherwise permitted by the plan (i.e., transfers, withdrawals, or loans involving assets credited to their plan accounts) will be suspended, restricted or limited for more than three consecutive business days. Section 306 of the Act also requires the company to timely notify directors and executive officers, as well as the SEC, when they will be subject to the statutory prohibition as a result of a qualifying blackout period. Regulation BTR clarifies that a public company must provide notice within five business days after becoming aware of an impending Section 306 blackout period, and no later than 15 calendar days before the actual or expected commencement of the Section 306 blackout period. If the company cannot provide advance notice within the prescribed period due to unforeseeable events or circumstances beyond the company’s reasonable control, the company still must provide notice as soon as reasonably practicable.

Violation of the blackout period trading prohibition by a director or an executive officer, or a violation of the reporting requirements by the company, is subject to SEC enforcement action and sanctions. In addition, any profits realized by a director or officer from a prohibited transaction are recoverable by the company.

Business Trends—What We Are Seeing

- Companies are making efforts to understand when blackout periods trigger trading restrictions, to identify covered plans and covered directors/executives, to establish procedures for triggering and facilitating trading suspensions, and to prepare SEC filing notices.
- Companies are developing a process for carefully tracing transaction histories in case director/executive dispositions are made during a pension blackout period.
- Plan administrators are notifying corporate insiders of their new reporting obligations when dealing with company stock held in their employer’s tax-qualified retirement plan.
- Safeguards in company plans are being developed to block prohibited trades during a blackout period.
- Companies are considering the implications of the new rules on plan loans made to executive officers and directors who participate in their plan.

SECTION 201

Prohibition of Certain Services by Auditors

On January 22, 2003, the SEC adopted final rules to implement the provisions of Title II (Auditor Independence) of the Act, including Section 201. Section 201 specifically prohibits a registered public accounting firm from providing the following services to a public company contemporaneously with audit services:

- Bookkeeping or other services to maintain or prepare the audit client's accounting records or financial statements
- Financial information systems design/implementation
- Appraisal or valuation services, fairness opinions, or contribution-in-kind reports
- Actuarial services
- Internal audit outsourcing services
- Management functions
- Human resources/executive recruiting services
- Broker or dealer, investment advisor, or investment banking services
- Legal/expert services unrelated to the audit
- Other services that the SEC or PCAOB determines are impermissible

Many of the services listed above were already prohibited under independence rules that the SEC adopted in 2000. To the extent that some of the prohibitions are new, such services were prohibited as of May 6, 2003, although services being provided pursuant to contracts in place as of May 6 may continue for up to 12 months (as long as they are not materially modified).

Business Trends—What We Are Seeing

- Dialogue between the audit committee and independent auditors related to all services has increased. Audit committees are proactively embracing their expanded role in the oversight of the financial reporting process and the relationship with the auditor.
- In the preapproval process, audit committees are carefully reviewing proposed services before determining that the independent auditors may provide permitted non-audit services.
- Some companies are adopting fee ratio policies related to services provided by the independent auditors (e.g., ratio of fees for certain non-audit services to fees for audit services).
- Some companies are identifying a second service provider for non-audit related services (e.g., internal audit outsourcing) that previously were being provided by the independent auditor.

SECTION 202

Audit Committee Preapproval of All Services by Auditors

All auditing and non-auditing services provided to a public company audit client by the independent auditor must be preapproved by the audit committee.

The rule requires that either:

- 1) The company's audit committee preapprove the specific audit or non-audit engagement to be rendered by the accounting firm, or
- 2) The engagement to render services is entered into pursuant to preapproval policies/procedures established by the audit committee, provided that:
 - (a) the policies/procedures are detailed as to the particular services to be provided;
 - (b) the audit committee is informed of each service; and
 - (c) the policies/procedures do not include delegation of the audit committee's responsibilities to management.

Because preapproval must be detailed as to the particular services to be provided, the audit committee's policies cannot provide for broad, categorical approvals. The appropriate level of detail for preapproval policies will differ depending upon the facts and circumstances. Whichever policy is adopted cannot result in a delegation of the audit committee's responsibility to management. In August, 2003, the SEC staff indicated that management cannot be called upon to make any judgment as to whether a proposed service has been preapproved by the audit committee. To the extent the policies and procedures used by the audit committee require, or in any way rely on, management to determine the preapproval of services, including the identification of services as being covered by the descriptions of services preapproved by the audit committee, such policies and procedures would not satisfy the SEC's requirements. In addition, an audit committee cannot use monetary limits for services as an alternative to specific preapproval of each non-audit service.

The new preapproval requirements became effective on May 6, 2003, for services that are to be performed pursuant to contracts entered into on or after this date. Services already in process and covered by contracts in existence prior to May 6 do not require preapproval by the audit committee and may continue for up to 12 months (if not materially modified).

Business Trends—What We Are Seeing

- Companies are establishing formal approval policies and procedures to implement the new preapproval requirements and set the tone for the desired service relationship with the independent auditors.
- Some audit committees are preapproving specific engagements. Other audit committees have adopted policies and procedures that allow them to review and approve certain recurring services annually, yet require them to review and approve other services on an engagement-by-engagement basis.
- Audit committees are receiving more specific information on the proposed services to be preapproved pursuant to their policies and procedures.
- Some audit committees are requiring that a strong case be developed to use the auditor for non-audit related services (e.g., clearly demonstrate that the auditor is better than the competition or the performance of the service is enhanced by its knowledge of the company).
- Many companies are establishing protocols globally for engaging the auditor and approving fees. Some companies are centralizing activities involving preapproval of services, fee negotiation and billing for services by the independent auditor.
- Some companies are requiring preapproval of all services by any accounting firm, not just the firm that serves as the independent auditor.

SECTION 203

Audit Partner Rotation

Section 203 requires the lead audit partner and the audit partner responsible for reviewing the audit (i.e., the concurring partner) to rotate off the audit every five years.

In implementing Section 203, the SEC concluded that the rotation rule should apply to more audit partners than just the lead and concurring audit partners. The lead partner and the concurring partner will be permitted to serve a maximum of five consecutive years with a five-year time-out before resuming any role that would again be subject to rotation. Other audit partners (i.e., those at the registrant or parent company level and those who lead the audit of a subsidiary whose assets or revenues constitute 20% or more of the consolidated total) will be permitted to serve a maximum of seven consecutive years with a two-year time-out.

Under the SEC transition provisions, partners in both the lead and concurring roles on domestic issuers must count prior years of service. However, the requirements for concurring partners (but not lead partners) on domestic issuers are deferred for one year. Other audit partners, including foreign partners, receive a “fresh start,” such that no prior years of service count against the new maximum years of service. The lead and other audit partner rotation requirements start with the company’s fiscal year beginning after May 6, 2003, effective for the first quarter’s Form 10-Q. Therefore, for companies with a calendar year end, rotation becomes effective for the first quarter ended March 31, 2004.

Business Trends—What We Are Seeing

- Companies with impending lead audit partner rotation are expressing concern about continuity and are requesting the earlier involvement of new partners to ensure a smooth transition.
- Audit committee members are becoming more involved in the lead audit partner selection processes.
- The rule will begin to have a more dramatic impact over the next year as audit firms and companies implement the new rotation requirements.

SECTION 206

Restrictions on Company Hiring of Audit Team Members

Section 206 requires that an employee of the audit firm who worked on the audit for a company must satisfy a “cooling off” period of one year before he or she can be hired by that company as CEO, controller, CFO, chief accounting officer, or an equivalent position.

The final SEC rule related to auditor independence adopts a broader scope than the Act by prohibiting employment of audit engagement team members (with limited exceptions) in a “financial reporting oversight role,” defined as persons exercising or in a position to exercise influence over the financial statements, and anyone who prepares those statements. For example, this would include a member of the board of directors or similar management or governing body, chief executive officer, president, chief financial officer, chief operating officer, general counsel, chief accounting officer, controller, director of internal audit, director of financial reporting, treasurer, or any equivalent position. This requirement is effective only for new employment arrangements commencing after May 6, 2003.

Business Trends—What We Are Seeing

- Too early to see an impact from the new rules; however, companies that may have historically hired audit engagement personnel for financial management positions will need to develop alternative hiring models.
- Companies are identifying critical jobs for which it would be inappropriate to draw from the audit engagement team.

Additional Information on Other Sections

	Section	Rule Description and Update
Reporting	Section 401 Off-Balance Sheet and Pro Forma Disclosures	<p>Section 401 requires disclosure in quarterly and annual reports of all material off-balance sheet transactions, arrangements, obligations (including contingent obligations), and other relationships with unconsolidated entities and others. The Act also requires disclosures related to pro forma/non-GAAP financial information.</p> <p>On January 27, 2003, the SEC published a final rule to require specific disclosures in Management's Discussion and Analysis (MD&A) about material off-balance sheet arrangements, as defined, and aggregate contractual obligations. The rule requires a registrant to present disclosure about off-balance sheet arrangements in a separately captioned section of MD&A. In contrast, a registrant may place the tabular disclosure of known contractual obligations in an MD&A location that it deems to be appropriate. Companies will be required to provide the new disclosures related to off-balance sheet arrangements in filings that include annual financial statements for fiscal years ending on or after June 15, 2003 (December 15, 2003 for aggregate contractual obligations).</p> <p>On January 22, 2003, the SEC adopted Regulation G, which requires that the public disclosure of a non-GAAP financial measure be accompanied by a numerical reconciliation, in a table or other clearly understandable format, to the most directly comparable GAAP measure. Regulation G also explicitly prohibits the presentation of inaccurate or misleading non-GAAP financial measures. For non-GAAP measures that exclude "non-recurring, infrequent or unusual" items, the rule prohibits excluding an item if the excluded item is reasonably likely to recur within two years or a similar item occurred within the prior two years. The rule applies to annual and quarterly reports for fiscal periods ending after March 28, 2003.</p>
	Section 409 Real Time Issuer Disclosures	<p>Section 409 requires the SEC to issue new rules mandating companies to disclose on a rapid and current basis additional information concerning material changes in the financial condition or operations of the company. The SEC has proposed rules that would significantly increase the number of corporate events that public companies must report in a Form 8-K and require Form 8-K reports to be filed within two business days of most reportable events. A final rule is expected later in 2003. In light of these new disclosure requirements, some companies are no longer providing detailed estimates of future earnings guidance. In addition, some companies are training employees to identify "material" changes that require disclosure and incorporating the process of identifying real time disclosure issues into their quarterly disclosure process.</p>
Roles	Section 402 Prohibition of Executive Loans	<p>Any director or executive officer of a public company cannot receive, directly or indirectly, credit in the form of a personal loan from the company. No new regulatory guidance has been issued with respect to Section 402. Accordingly, companies are consulting with private law firms for interpretation and advice on compliance. Also, companies are assessing their means for monitoring financial transactions with executives and directors to ensure they comply with regulatory requirements.</p>
	Section 407 Disclosure of Audit Committee Financial Expert	<p>A company must disclose whether it has a financial expert on the audit committee. On January 23, 2003, the SEC published a final rule implementing Section 407 of the Act. Companies are required to provide the new disclosures in annual reports for fiscal years ending on or after July 15, 2003 (December 15, 2003 for small business issuers). In light of these new requirements, companies are actively evaluating the backgrounds of audit committee members, recruiting new members that qualify as financial experts, and providing initial and ongoing training to existing members to increase financial literacy, as necessary. Companies with more than one financial expert are seeking input from outside counsel on whether to name only one expert or disclose all financial experts.</p>

Section	Rule Description and Update
Section 303 <i>Improper Influence on Conduct of Audits</i>	<p>Section 303 makes it unlawful for any director/officer or others acting at their direction to fraudulently influence, coerce, manipulate or mislead any independent auditor. On May 20, 2003, the SEC published its final rule to implement Section 303. The rule, which applies to all public companies (including small business and foreign private issuers), became effective on June 27, 2003. The prohibition includes both intentional and negligent actions that mislead the auditor.</p> <p>Prohibited actions include, but are not be limited to, improperly influencing the auditor to: (a) issue or reissue an inappropriate audit report on the company's financial statements due to material violations of GAAP, GAAS, or other professional or regulatory standards, (b) not perform audit, review, or other procedures required by GAAS or other professional standards, (c) not withdraw as appropriate a previously issued audit report, and (d) not communicate matters to the company's audit committee. The SEC believes that third parties (e.g., employees, customers, vendors, creditors, attorneys, advisors) providing information or analyses to an auditor should exercise reasonable attention and care in those communications. However, the SEC does not intend to hold any party accountable for honest and reasonable mistakes or to sanction those who actively debate accounting or auditing issues.</p>
Section 403 <i>Accelerated Reporting of Trades by Insiders</i>	<p>Section 403 requires accelerated reporting of trades by insiders. Any person who beneficially owns more than 10% of the company's registered equity securities and each officer and director of the company (insiders) are required to file Form 3 to report their beneficial ownership of a company's equity securities initially; Form 4 to report subsequent changes in their ownership; and Form 5 to report annually their beneficial ownership. Insiders are required to file Form 4 before the end of the second business day following execution of the transaction. On May 7, 2003, the SEC published its final rule requiring electronic filing via EDGAR of all insider reports effective June 30, 2003. The SEC rule also will require each company with a corporate Web site to post all insider reports with respect to its equity securities by the end of the business day after the report's filing, and the forms must remain accessible on the company's Web site for at least a 12-month period.</p>
Section 406 <i>Code of Ethics for Senior Financial Officers</i>	<p>On January 23, 2003, the SEC published its final rules to implement Section 406 of the Act. The rules require a company to disclose annually whether it has adopted a code of ethics (as defined) for its CEO and its other senior financial officers (e.g., CFO, controller). If it has a code, it must make it publicly available. If the company does not have a code, it must explain why not. Companies will be required to provide the new disclosures in annual reports for fiscal years ending on or after July 15, 2003 (December 15, 2003 for small business issuers). Once a company files its first annual report with the required disclosures, it also will be required to report significant amendments to its code of ethics, or any waivers, affecting the specified officers. The rules apply to public companies (except issuers of asset-backed securities), including small business issuers and foreign private issuers. Separately, the SEC issued new disclosure rules applicable to registered investment companies to implement Section 406 of the Act. Some companies are adopting a code of ethics for all employees, not just officers.</p>
Section 806 <i>Protection for Whistleblowers</i>	<p>Section 806 of the Act provides whistleblower protection by making it unlawful to discharge, harass, or otherwise discriminate against employees who provide evidence of fraud. Companies are revising their codes of ethics and complaint processes in light of this new rule. In order to maintain integrity in the process of investigating issues raised by whistleblowers, many companies are considering using outside vendors to handle initial calls into a hotline or Web site and to aid in the investigation of the complaint.</p>

Conduct

	Section	Rule Description and Update
Enforcement	Sections 101 & 102 Public Company Accounting Oversight Board Authority Established	<p>The Act created the Public Company Accounting Oversight Board (PCAOB) to oversee the audit of public companies. The PCAOB must establish auditing, quality control, ethics, and independence standards related to audit reports, conduct inspections of audit firms, and enforce compliance with rules relating to audit reports. Accounting firms must register with the PCAOB in order to audit public companies. The PCAOB will also submit an annual report to the SEC.</p> <p>On April 25, 2003, the SEC, in accordance with Section 101(d) of the Act, determined that PCAOB was appropriately organized and had the capacity to carry out the Act's requirements and to enforce compliance by registered public accounting firms. The SEC also approved PCAOB Rules 3200T through 3600T, which adopted existing auditing, attestation, quality control, ethics, and independence standards as transitional standards that will remain in effect until the PCAOB completes a review to determine whether any of these standards should be modified, replaced, or repealed.</p>
	Section 104 Inspections of Public Accounting Firms	<p>The PCAOB is required to conduct a continuing program of inspections to assess the degree of compliance of each registered public accounting firm with the Act and applicable rules and professional standards. The PCAOB will conduct inspections of the larger registered firms (i.e., those that provide audit reports for more than 100 companies) on an annual basis. Smaller firms will receive inspections at least once every three years.</p>
	Section 108 Accounting Standards	<p>Section 108 confirms that the SEC may recognize, as "generally accepted" for purposes of the securities laws, any accounting principles established by an appropriate standard-setting body, as defined. The SEC issued a policy statement in 2003 recognizing the FASB's financial accounting and reporting standards as generally accepted. Section 108 clarifies that the Act does not impair or limit the authority of the SEC to establish accounting principles or standards for purposes of enforcement of the securities laws.</p> <p>Section 108 also requires the SEC to conduct a study on the adoption by the U.S. financial reporting system of a "principles-based" accounting system. In early August 2003, the SEC issued its study, which does not advocate either a rules-based or a principles-based approach. Rather, it recommends an "objectives-oriented" approach whereby the accounting objective of the accounting standard is clearly stated, sufficient detail and structure are provided for the standard to be operationalized and applied consistently, and "bright lines" are avoided so that companies cannot achieve technical compliance while evading the intent of the standard and the economic substance of the transactions. According to the SEC, rules-based standards are characterized by bright-line tests, multiple exceptions, a high-level of detail, and internal inconsistencies. This can result in financial reporting that does not reflect the economic substance of transactions and events. Principles-based standards, on the other hand, are high-level standards that often do not provide sufficient detail for preparers and auditors to frame appropriate judgments. The study points out that, in the long-run, the FASB most likely will issue more standards that rely on fair value as the measurement attribute, and the study acknowledges that the FASB has already begun to shift to objectives-oriented standards and that it expects the FASB to continue to move in that direction. The SEC staff views the FASB's shift to a more objectives-oriented regime as an integral part of its stated intentions to seek greater convergence between U.S. and international standards. The SEC staff study recognizes that transitioning from a rules-based approach to an objectives-oriented approach will take time and involve difficult choices. The full SEC study is available on the SEC's Web site.</p>

ADDITIONAL INFORMATION
ON OTHER SECTIONS

	Section	Rule Description and Update
Enforcement	Section 109 <i>Funding for PCAOB/FASB</i>	Companies must pay annual fees, based upon market capitalization, to support the PCAOB and the FASB. Both will develop a formula-based computation on a sliding scale for calculating fees. The larger market valuation a company has, the more its fee will be. Companies with a market capitalization of less than \$25 million will be exempt from paying a fee. Companies that do not pay the fee within an allotted time frame could be subject to enforcement action.
	Section 408 <i>Increased SEC Reviews of Public Filings</i>	Section 408 requires an expanded SEC review of 10-Ks and 10-Qs. Disclosures made by public companies in periodic reports shall be reviewed by the SEC on a regular basis, but not less than once every three years. Factors impacting the scheduling of the reviews by the SEC will include, among others, material restatements of financial results, volatile stock prices, large market capitalization, emerging companies with disparities in their P/E ratios, and companies that significantly affect any material sector of the economy.
	Section 307 <i>Rules of Professional Responsibility for Attorneys</i>	Section 307 requires attorneys to report evidence of a material violation of securities laws. An attorney must report evidence of a material violation of securities laws “up-the-ladder” within the company to the chief legal counsel or the chief executive officer of the company, or the equivalent. If the chief legal counsel or the chief executive officer of the company does not respond appropriately to the evidence, the attorney is required to report the evidence to the audit committee, another committee of independent directors, or the full board of directors.
Penalties	Section 304 <i>Forfeiture of Certain Bonuses and Profits</i>	Section 304 requires the CEO and CFO to forfeit bonuses (or other incentive/equity-based compensation) received and profits realized on the sale of securities in the 12 months following a financial report that is later restated due to material noncompliance with any financial reporting requirement under the securities laws, as a result of misconduct.
	Section 804 <i>Statute of Limitations for Securities Fraud</i>	Section 804 extends statute of limitations for private securities litigation alleging fraud. The statute of limitations is extended to the earlier of two years after the discovery of the facts constituting the violation, or five years after such violation.
	Section 906 <i>Management Certifications (Criminal Provision)</i>	<p>Section 906 of the Act, a criminal provision that was effective immediately upon signing of the Act, requires that a management certification by the CEO and CFO “accompany” each periodic report that includes financial statements. The certification (separate from the Section 302 certification) must state that the periodic report “fully complies” with the requirements of Exchange Act Section 13(a) and 15(d) and that “information contained in the periodic report ‘fairly presents,’ in all material respects, the financial condition and results of operations of the issuer.”</p> <p>Section 906 provides for criminal penalties for an officer who provides the certification “knowing” it to be untrue of up to a \$1 million fine and imprisonment of 10 years (with harsher penalties for “willful” violations). Section 906 certifications must be “furnished” (versus filed) as Exhibit 32 to annual (10-K) and quarterly (10-Q) SEC reports. As furnished information, the Section 906 certification would not be subject to the civil liability provisions of Section 18 of the Exchange Act, and would not be incorporated by reference into Securities Act registration statements unless the company expressly specifies otherwise. The SEC is currently considering, in consultation with the Department of Justice, whether Section 906 should also be applied to current reports on Forms 6-K and 8-K and annual reports on Form 11-K.</p>

Penalties	Section	Rule Description and Update
	<p>Sections 1102 & 802 Record Tampering or Otherwise Impeding an Official Proceeding And Criminal Penalties for Altering Documents</p>	<p>Section 1102 provides for criminal penalties for: (1) corruptly altering, destroying, mutilating, or concealing a record or document with the intent to impair an official proceeding, or (2) corruptly obstructing, influencing or impeding an official proceeding. Companies need to develop and maintain rules for enforcing document-retention policies including electronic record retention.</p> <p>Section 802 expands criminal penalties for whoever alters documents, including the destruction of corporate audit records, in order to obstruct an investigation. The related SEC rule (Rule 2-06 issued on January 24, 2003) requires accountants who audit or review a company's financial statements to retain specified records for a period of seven years from the end of the fiscal year in which an audit or review was concluded.</p>
<p>Section 105 Investigations/Disciplining of Accountants</p>	<p>Section 105 of the Act authorizes the PCAOB to establish procedures for the investigation and disciplining of registered public accounting firms. It also increases the penalties for accountants for failure to testify, produce documents or cooperate with an investigation.</p>	

Self-Assessment Analysis

Candid self-assessment is integral to effective corporate governance. A focused evaluation of the current state of your organization's readiness to comply with the requirements of the Sarbanes-Oxley Act of 2002 relative to reporting, roles, conduct, enforcement, penalties, and relationships will allow you to develop a clear, consistent, and measurable plan for improvement.

The following chart was developed to assist you in assessing your performance relative to the requirements of Sarbanes-Oxley. Complete the self-assessment by checking off the box next to the value that best describes your organization's present status with respect to complying with each section of the Act. We have included all sections of the Act in this chart. Sections that are not directly applicable to SEC registrants have been shaded gray and should be assessed as N/A. The assessment should include the perceptions of both the audit committee and management.

Section	Current State Assessment of Process	Action Plan
Reporting: Upgrade Disclosures		
302 - Management Certifications	<input type="checkbox"/> Strong <input type="checkbox"/> Adequate <input type="checkbox"/> Improvement Needed <input type="checkbox"/> NA	
401 - Off-Balance Sheet and Pro Forma Disclosures	<input type="checkbox"/> Strong <input type="checkbox"/> Adequate <input type="checkbox"/> Improvement Needed <input type="checkbox"/> NA	
404 - Evaluation of Internal Controls	<input type="checkbox"/> Strong <input type="checkbox"/> Adequate <input type="checkbox"/> Improvement Needed <input type="checkbox"/> NA	
409 - Real Time Issuer Disclosures	<input type="checkbox"/> Strong <input type="checkbox"/> Adequate <input type="checkbox"/> Improvement Needed <input type="checkbox"/> NA	
Roles: Strengthen Corporate Governance		
204 - Auditor Communications with Audit Committees	<input type="checkbox"/> Strong <input type="checkbox"/> Adequate <input type="checkbox"/> Improvement Needed <input type="checkbox"/> NA	
301 - Audit Committee Standards	<input type="checkbox"/> Strong <input type="checkbox"/> Adequate <input type="checkbox"/> Improvement Needed <input type="checkbox"/> NA	
402 - Prohibition of Executive Loans	<input type="checkbox"/> Strong <input type="checkbox"/> Adequate <input type="checkbox"/> Improvement Needed <input type="checkbox"/> NA	
407 - Disclosure of Audit Committee Financial Expert	<input type="checkbox"/> Strong <input type="checkbox"/> Adequate <input type="checkbox"/> Improvement Needed <input type="checkbox"/> NA	
Conduct: Expand Insider Accountability		
303 - Improper Influence on Conduct of Audits	<input type="checkbox"/> Strong <input type="checkbox"/> Adequate <input type="checkbox"/> Improvement Needed <input type="checkbox"/> NA	
306 - Insider Trades During Pension Fund Blackout Periods	<input type="checkbox"/> Strong <input type="checkbox"/> Adequate <input type="checkbox"/> Improvement Needed <input type="checkbox"/> NA	
403 - Accelerated Reporting of Trades by Insiders	<input type="checkbox"/> Strong <input type="checkbox"/> Adequate <input type="checkbox"/> Improvement Needed <input type="checkbox"/> NA	
406 - Code of Ethics for Senior Financial Officers	<input type="checkbox"/> Strong <input type="checkbox"/> Adequate <input type="checkbox"/> Improvement Needed <input type="checkbox"/> NA	
806 - Protection for Whistleblowers	<input type="checkbox"/> Strong <input type="checkbox"/> Adequate <input type="checkbox"/> Improvement Needed <input type="checkbox"/> NA	

Section	Current State Assessment of Process	Action Plan
Enforcement: Increase Oversight		
101 & 102 - PCAOB Authority Established	<input type="checkbox"/> Strong <input type="checkbox"/> Adequate <input type="checkbox"/> Improvement Needed <input checked="" type="checkbox"/> NA	
104 - Inspections of Public Accounting Firms	<input type="checkbox"/> Strong <input type="checkbox"/> Adequate <input type="checkbox"/> Improvement Needed <input checked="" type="checkbox"/> NA	
108 - Accounting Standards	<input type="checkbox"/> Strong <input type="checkbox"/> Adequate <input type="checkbox"/> Improvement Needed <input checked="" type="checkbox"/> NA	
109 - Funding for PCAOB/FASB	<input type="checkbox"/> Strong <input type="checkbox"/> Adequate <input type="checkbox"/> Improvement Needed <input type="checkbox"/> NA	
408 - Increased SEC Reviews of Public Filings	<input type="checkbox"/> Strong <input type="checkbox"/> Adequate <input type="checkbox"/> Improvement Needed <input checked="" type="checkbox"/> NA	
307 - Rules of Professional Responsibility for Attorneys	<input type="checkbox"/> Strong <input type="checkbox"/> Adequate <input type="checkbox"/> Improvement Needed <input type="checkbox"/> NA	
Penalties: Broaden Sanctions		
304 - Forfeiture of Certain Bonuses and Profits	<input type="checkbox"/> Strong <input type="checkbox"/> Adequate <input type="checkbox"/> Improvement Needed <input type="checkbox"/> NA	
804 - Statute of Limitations for Securities Fraud	<input type="checkbox"/> Strong <input type="checkbox"/> Adequate <input type="checkbox"/> Improvement Needed <input type="checkbox"/> NA	
906 - Management Certifications (Criminal Provision)	<input type="checkbox"/> Strong <input type="checkbox"/> Adequate <input type="checkbox"/> Improvement Needed <input type="checkbox"/> NA	
1102 & 802 - Record Tampering or Otherwise Impeding an Official Proceeding And Criminal Penalties for Altering Documents	<input type="checkbox"/> Strong <input type="checkbox"/> Adequate <input type="checkbox"/> Improvement Needed <input type="checkbox"/> NA	
105 - Investigations/ Disciplining of Accountants	<input type="checkbox"/> Strong <input type="checkbox"/> Adequate <input type="checkbox"/> Improvement Needed <input checked="" type="checkbox"/> NA	
Relationships: Heighten Auditor Independence		
201 - Prohibition of Certain Services by Auditors	<input type="checkbox"/> Strong <input type="checkbox"/> Adequate <input type="checkbox"/> Improvement Needed <input type="checkbox"/> NA	
202 - Audit Committee Preapproval of All Services by Auditors	<input type="checkbox"/> Strong <input type="checkbox"/> Adequate <input type="checkbox"/> Improvement Needed <input type="checkbox"/> NA	
203 - Audit Partner Rotation	<input type="checkbox"/> Strong <input type="checkbox"/> Adequate <input type="checkbox"/> Improvement Needed <input type="checkbox"/> NA	
206 - Restrictions on Company Hiring of Audit Team Members	<input type="checkbox"/> Strong <input type="checkbox"/> Adequate <input type="checkbox"/> Improvement Needed <input type="checkbox"/> NA	





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