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**MEMORANDUM**

October 31, 2002

To Our Clients and Friends

Re: SEC's Proposed Rule on Disclosures  
Under the Sarbanes-Oxley Act of 2002

To implement Sections 404, 406 and 407 of the Sarbanes-Oxley Act of 2002, the Securities and Exchange Commission ("SEC") has proposed rules to require companies to include three new disclosures in their filings under the Securities Exchange Act of 1934 (the "Exchange Act"). These disclosures must be made by all companies required to file Form 10-K or 10-KSB as well as private foreign issuers and Canadian issuers. Comments on the proposed rule are due by November 29, 2002.

**DISCLOSURE RE AUDIT COMMITTEE FINANCIAL EXPERTS**

Under the proposed rule a company would be required to disclose in its annual report:

- the number and names of persons that the board of directors has determined to be the financial experts serving on the company's audit committee; and
- whether the financial experts are "independent" and if not, an explanation of why they are not.

If the company does not have a financial expert on its audit committee, it must disclose that fact and explain why.

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### **DISCLOSURE RE CODE OF ETHICS**

Under the proposed rule a company would be required to disclose in its annual report:

- whether the company has adopted a written code of ethics that applies to the company's principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions; and
- if the company has not adopted such a code of ethics the reasons it has not done so.

A company would have to file a copy of its ethics code as an exhibit to its annual report.

In addition, any changes to a company's code of ethics that apply to the specified officers or a waiver of any ethics code provision to a specified officer must be reported on Form 8-K within two business days after the change is made or the waiver granted. A company may elect to disseminate these changes/waivers via its web site rather than using the Form 8-K provided that in its most recently filed annual report on Form 10-K or 10-KSB, it has 1) given notice that it intends to do this and 2) provided its web site address.

### **DISCLOSURE RE INTERNAL CONTROLS AND PROCEDURES FOR FINANCIAL REPORTING<sup>1</sup>**

Under the proposed rule a company would be required to include in its annual report an internal control report of management that contains:

- a statement of management's responsibilities for establishing and maintaining adequate internal controls and procedures for financial reporting;

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<sup>1</sup> The SEC is coordinating with the Federal Deposit Insurance Corporation and other federal banking regulators to eliminate, to the extent possible, any unnecessary duplication between the SEC's proposed internal control report and the FDIC's internal control report requirements. However, bank and thrift holding companies that are required to file reports under section 13(a) or 15(d) of the Exchange Act would be subject to these internal reporting requirements.

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- management’s conclusions about the effectiveness of the company’s internal controls and procedures for financial reporting based on management’s evaluation of those controls and procedures; and
- a statement that the registered public accounting firm that prepared or issued the company’s audit report relating to the financial statements included in the company’s annual report has attested to, and reported on, management’s evaluation of the company’s internal controls and procedures for financial reporting.

The “attestation” report by the registered public accounting firm must be filed in the company’s annual report. The proposed rule does not specify the exact content of the proposed internal control report but expects management to tailor the report to a company’s circumstances.

Issuers of asset-backed securities are not required to make disclosures relating to internal controls and procedures, code of ethics and audit committee financial experts.

The SEC is also proposing to amend its recent rules requiring certification of a company’s quarterly and annual reports to require a company’s management to evaluate the effectiveness of the design and operation of the company’s internal controls and procedures for financial reporting, as well as its disclosure controls and procedures, for each annual and quarterly report that it is required to file under the Exchange Act. This evaluation must be made by the end of the period covered by the report rather than within the 90-day period prior to the filing date as is currently required.

### **DEFINITIONS**

A “financial expert” is a person who has, through education and experience as a public accountant or auditor or a principal financial officer, controller, or principal accounting officer, of a company that, at the time the person held such position, was required to file reports pursuant to section 13(a) or 15(d) of the Exchange Act, or experience in one or more positions that involve the performance of similar functions (or that results, in the judgment of the company’s board of directors, in the person’s having similar expertise and experience), the following attributes:

- an understanding of generally accepted accounting principles and financial statements;

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- experience applying such generally accepted accounting principles in connection with the accounting for estimates, accruals, and reserves that are generally comparable to the estimates, accruals and reserves, if any, used in the registrant's financial statements;
- experience preparing or auditing financial statements that present accounting issues that are generally comparable to those raised by the registrant's financial statements;
- experience with internal controls and procedures for financial reporting; and
- an understanding of audit committee functions.

A "code of ethics" is a codification of standards that is reasonably designed to deter wrongdoing and to promote:

- honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships;
- avoidance of conflicts of interest including disclosure to an appropriate person or persons identified in the code of any material transaction or relationship that reasonably could be expected to give rise to such a conflict;
- full, fair, accurate, timely and understandable disclosure in reports and documents that a company files with, or submits to, the Commission and in other public communications made by the company;
- compliance with applicable governmental laws, rules and regulations;
- the prompt internal reporting to an appropriate person or persons identified in the code of violations of the code; and
- accountability for adherence to the code.

The proposed rule can be found at <http://www.schwartzandballen.com/WhatsNew.htm>.

If you have any questions concerning the proposed rule, please call Gilbert Schwartz, Robert Ballen or Tom Fox at (202) 776-0700.