

November 2002

In This Issue:

SEC I: Proposed Pro Forma Rules, Regulation G and "Real-Time" Disclosure
SEC II: Off-Balance Sheet Rules Proposed
SEC III: Proposed Rules on Internal Control Reports
SEC IV: Proposed Rules on Code of Ethics
SEC V: Definition of "Financial Expert" Proposed
SEC VI: Proposed Rules on Improper Auditor Influence
SEC VII: Proposed NYSE and Nasdaq Rules on Stockholder Approval of Option

Plans

Pension Blackout Periods: SEC and DOL Propose Rules
Public Company Accounting Oversight Board: Members Appointed
Disclosure Controls and Procedures: What to Do Now, Part II
Executive Compensation: The Conference Board's Commission Report
Loans: More on Evolving Positions
Ethics: ABA Presidential Task Force on Corporate Responsibility Hearings
Corporate Governance: Directors Weigh In
What's Up Online: More and Improved XBRL Filings
Comings and Goings: Who's Doing What and Where
Events Calendar

Program:

A transcript from our "**Disclosure Controls and Procedures**" program held on October 24th is available at <http://www.realcorporatelawyer.com/CLE/CLE10-24-02Transcript.html>

Upcoming Programs: We will host three in November!!! [Visit our Online Programs Page to find out more.](#) These programs include:

On Tuesday, November 12, 2002 (4:00 - 4:45 pm EST), the complimentary teleconference is "**Shareholder Proposals: What to Expect in the 2003 Proxy Season.**" The panel includes:

Marty Dunn, Deputy Director, Securities & Exchange Commission
Nell Minow, Editor, The Corporate Library
John Wilcox, Vice Chairman, Georgeson Shareholder
Beth Young, Corporate Governance Consultant

On Wednesday, November 20, 2002 (4:00 - 5:00 pm EST), the complimentary teleconference is "**Executive Compensation Practices: Ripe for Reform?**" The panel includes:

Carolyn Brancato, Director, Global Corporate Governance Research Center, The Conference Board

Charles Elson, Professor/Chair, Univ. of Delaware's Center for Corporate Governance

Patrick McGurn, Director of Corporate Programs, Institutional Shareholder Services

David Swinford, Partner, Pearl Meyers & Partners

Marc Trevino, Partner, Sullivan & Cromwell

On Monday, November 25, 2002 (10:00 - 10:45 am EST), the complimentary teleconference is "**Impact of Sarbanes-Oxley on Non-U.S. Companies.**" The panel includes:

Paul Dudek, Chief, Office of International Corporation Finance, U.S. Securities & Exchange Commission

Ed Greene, Partner, Cleary, Gottlieb Steen & Hamilton

Paul Kumleben, Partner, Davis Polk & Wardwell

Linda Quinn, Partner, Shearman & Sterling

To register for any - or all - of these programs, get the registration form at <http://www.realcorporatelawyer.com/CLE/CLERegister.html>.

SEC I: Proposed Pro Forma Rules, Regulation G and "Real-Time"

Disclosure

Today, the SEC proposed new rules regarding the use of pro forma financial information in order to implement Section 401(b) of Sarbanes-Oxley. In addition, under Section 409 of Sarbanes-Oxley, the SEC proposed a "real-time" disclosure framework as noted below.

Section 401(b) directs the SEC to adopt final rules requiring that any public disclosure or release of "pro forma financial information" be presented in a manner that (1) does not contain an untrue statement of a material fact or omit to state a material fact necessary in order to make the "pro forma financial information," in light of the circumstances under which it is presented, not misleading; and (2) reconciles the "pro forma financial information" presented with the financial condition and results of operations of the company under GAAP. The SEC proposed to meet the mandate of Section 401(b) by defining the category of financial information that is subject to that mandate - and then taking a two-step approach to regulating the use of that financial information.

To avoid confusion with the "pro forma" terminology that already exists in the SEC's rules, the SEC used the term "non-GAAP financial measure" for this rulemaking. For this purpose, a "non-GAAP financial measure" would be a numerical measure of a company's financial performance that: (1) excludes amounts, or is subject to adjustments that have

the effect of excluding amounts, that are included in the comparable measure calculated and presented in accordance with GAAP in the statement of income, balance sheet or statement of cash flows (or equivalent statements) of the issuer; or (2) includes amounts, or is subject to adjustments that have the effect of including amounts, that are excluded from the comparable measure so calculated and presented. Statistical and operating measures would not be covered.

The SEC's proposed new Regulation G would apply whenever a company publicly discloses or releases material information that includes a non-GAAP financial measure. Regulation G would prohibit material misstatements or omissions that would make the presentation of the material non-GAAP financial measure, under the circumstances in which it is made, misleading, and would require a quantitative reconciliation (by schedule or other clearly understandable method) of the differences between the non-GAAP financial measure presented and the comparable financial measure or measures calculated and presented in accordance with GAAP.

For foreign private issuers, Regulation G would provide a limited exception where (1) the securities of the issuer are listed or quoted on a securities exchange or inter-dealer quotation system outside the United States; (2) the non-GAAP financial measure and the most comparable GAAP financial measure are not calculated and presented in accordance with generally accepted accounting principles in the United States; and (3) the disclosure is made by or on behalf of the issuer outside the United States, or is included in a written communication that is released by or on behalf of the issuer only outside the United States.

As for "real-time" disclosure, Section 409 requires the SEC to conduct rulemaking to require companies to disclose "on a rapid and current basis such additional information concerning material changes in the financial condition or operations of the issuer . . . as the Commission determines, by rule, is necessary or useful for the protection of investors and in the public interest." To meet this requirement, the SEC proposed to amend Form 8-K to require companies to file releases or announcements disclosing material non-public financial information about completed annual or quarterly fiscal periods.

This "real-time" disclosure proposal would not require the issuance of earnings releases or similar announcements. However, such releases and announcements would trigger the new proposed filing requirement. The proposed filing requirement would apply regardless of whether the release or announcement included disclosure of a non-GAAP financial measure.

The SEC also proposed not to require companies to file their financial information for a completed fiscal period if the presentation was made orally, telephonically, by webcast, broadcast or similar means - and if (1) the presentation occurs within 48 hours of a related release or announcement that is filed on Form 8-K; (2) the presentation is accessible to the public; and (3) the information in the webcast is posted on the company's website.

There is a 30-day comment period for this proposal - the SEC is required to adopt final rules by January 26, 2003. The SEC has not yet issued its proposing release.

SEC II: Off-Balance Sheet Rules Proposed

Today, the SEC proposed rules relating to off-balance sheet arrangements, as required by Section 401(a) of Sarbanes-Oxley. While current MD&A rules already require a company to provide disclosure about its off-balance sheet arrangements to the extent necessary to an understanding of the company's financial condition, changes in financial condition and results of operations, the proposed rules would more specifically address the types of disclosure that companies must provide.

The proposed rules would require companies to provide in their "Management's Discussion and Analysis": (a) a discussion of off-balance sheet arrangements; (b) a table of aggregate contractual obligations due in short and long-term time horizons; and (c) either a table or textual disclosure of aggregate contingent liabilities and commitments in the short and long-term. This disclosure would be required in a special labeled section of MD&A.

More importantly, the threshold by which disclosure would be required would be a lower threshold as compared to the SEC's "reasonably likely" standard used in January (when the SEC issued a "statement" to elicit this type of disclosure). At the open Commission meeting, Chairman Pitt noted that the proposed standard - that would require disclosure if the likelihood of the transaction having a material effect on the company is more than "remote" - was arguably a higher standard than the one that Congress drafted into Sarbanes-Oxley (i.e. a "may" be material threshold).

However, the Chairman noted his concern about eliciting too much disclosure (some of which would have limited utility) that might overwhelm other disclosures - and mentioned a willingness to exercise the SEC's exemptive authority to provide relief if need be. In addition, the Chairman was concerned about applying different disclosure thresholds to different sections of MD&A.

Although Sarbanes-Oxley directed the SEC to require the off-balance sheet arrangement disclosure only in a company's annual and quarterly reports, the SEC proposed to also require a company to include this disclosure in the MD&A section of its Securities Act registration statements.

There is a 30-day comment period for this proposal - the SEC is required to adopt final rules by January 26, 2003. The SEC's proposing release is not yet available.

SEC III: Proposed Rules on Internal Control Reports

In mid-October, as mandated under Section 404 of Sarbanes-Oxley, the SEC proposed rules would require companies (including non-U.S. companies) to include an "internal control report" in their annual reports containing:

- a statement of management's responsibilities for establishing and maintaining adequate internal controls and procedures for financial reporting,
- conclusions about the effectiveness of the company's internal controls and procedures for financial reporting based on management's evaluation as of the end of the company's most recent fiscal year; and
- a statement that the company's auditors have attested to - and reported on - management's evaluation (with the attestation being filed with the annual report).

The SEC's proposal provides flexibility for companies to tailor their internal control reports to their own circumstances - so there is no mandated form for the report. However, the Commission noted that the SEC staff will monitor what companies disclose in their internal control reports in targeted reviews next year to ensure that the "spirit" of this new requirement is being followed.

At the related open Commission meeting, the SEC noted that these internal control reports should have a profound impact on how closely independent auditors pay attention to their client's internal controls (due to the attestation requirement). This was a primary reason for not accelerating the due date for next year's 10-K in a recent rulemaking.

In the release, the SEC attempts to clarify the distinction between "internal controls" and "disclosure controls." The SEC notes that "internal controls" are procedures designed to assure that transactions are properly authorized, that assets are safeguarded and that transactions are properly recorded for financial reporting purposes - and that "disclosure controls" are procedures designed to ensure that information required to be disclosed is captured and reported in a timely fashion. However, many practitioners still are confused about what the distinction is - as noted below under ["Disclosure Controls and Procedures: What to Do Now, Part II."](#)

The SEC also proposes modifying its recently adopted rules relating to certifications under Section 302 of the Act. The effect of the modification would be to go beyond what is mandated under Sarbanes-Oxley - which mandates an annual review of internal controls - to impose a quarterly evaluation as well. Many practitioners are confused as to whether this means the quarterly evaluation has to be a full-blown evaluation - or whether it can be a mere update.

The current rules under Section 302 require the inclusion in quarterly and annual reports of:

- a certification of the accuracy of the periodic report,

a statement of management responsibility for, and an evaluation of, the adequacy of disclosure controls; and
a statement that any deficiencies in internal controls have been reported.

The proposed rules would require CEOs and CFOs to add a statement of management responsibility for - and an evaluation of - the company's internal controls to their Section 302 certifications. The evaluations would be required to be conducted as of the end of the period covered by the report.

There is a 30-day comment period for this proposal - and as proposed, the rules regarding internal control reports would include a transition period (applying to annual reports for fiscal years ending on or after September 15, 2003).

The proposing release is available at <http://www.sec.gov/rules/proposed/33-8138.htm>.

SEC IV: Proposed Rules on Code of Ethics

In mid-October, as mandated under Section 406 of Sarbanes-Oxley, the SEC proposed rules that would require companies (including non-U.S. companies) to disclose whether they have adopted a code of ethics for their CEO, CFO, principal accounting officer, controller or persons performing similar functions in their annual reports (and if not, why not). In addition, a copy of the code of ethics would be required to be filed as an exhibit to the annual report.

Under the proposed rules, the SEC broadly defined what should be included in a code of ethics - and acknowledged that it expects ethics codes to vary as each company must design them as appropriate to its own business, procedures and processes.

As for waivers or changes of a code, companies would be required to disclose them in a Form 8-K - or on the company's website within two business days. Violations of a company's code would be considered "de facto" waivers. The proposal that companies could use their websites in lieu of 8-K disclosure would be available only to companies that had disclosed - in their most recent annual report - that they intend to disclose such events on their website and identified the relevant website address. Foreign private issuers would make such disclosure as exhibits to their Forms 20-F or 40-F - or could do so earlier on Form 6-K or their website.

As one observer remarked at the open Commission meeting, the SEC appears to be getting "code happy." The Commission requested comment whether this rulemaking should be broadened to cover more than just CEOs and CFOs (this rulemaking already goes beyond what Sarbanes-Oxley dictated - that Act only mentioned codes that apply to CFOs). The Commission requested comment on whether codes should apply to directors, investor relations' professionals, and others.

At the related open Commission meeting, Commissioner Campos read a statement to express his view that companies should go beyond the letter of the law to ensure that ethical values are valued within all corporate cultures.

There is a 30-day comment period for this proposal - the SEC is required to adopt final rules by January 26, 2003.

The proposing release - No. 33-8138 - is available at <http://www.sec.gov/rules/proposed/33-8138.htm>. To read Commissioner Campos' statement, see <http://www.sec.gov/news/speech/spch593.htm>.

SEC V: Definition of "Financial Expert" Proposed

In mid-October, as mandated under Section 407 of Sarbanes-Oxley, the SEC proposed rules that would require companies (including non-U.S. companies) to disclose the number and names of audit committee members whom the board determined to be "financial experts" in their annual reports - or to explain why the audit committee has no financial experts. In addition, companies would be required to disclose whether these financial experts are independent (and if not, why not).

As proposed by the SEC, "financial expert" would mean 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 publicly reporting company, or experience in one or more positions involving similar functions - the following attributes:

- an understanding of GAAP and financial statements;
- experience in applying GAAP in accounting for estimates, accruals, and reserves that is generally comparable to the accounting for those items in the company's financial statements;
- experience preparing or auditing financial statements that present accounting issues generally comparable to the issues raised by the company's financial statements;
- experience with internal controls and financial reporting procedures; and
- an understanding of audit committee functions.

This definition is more narrow than the existing stock exchange rules regarding the "financial expertise" of audit committee members - partly because Sarbanes-Oxley restricts the SEC's authority to define "financial expert" to a person who is a public accountant or auditor, or who has served as a senior financial officer of another company. It is expected that the SEC will receive numerous comments regarding whether the proposed definition is too narrow - so that it would be difficult for smaller companies to recruit persons that are eligible to serve as "financial experts."

The proposing release clarifies that "financial experts" will not be "experts" for purposes of Section 11 of the Securities Act of 1933. In addition, the release states that these experts will have "no higher degree of individual responsibility or obligation" than other members of the audit committee. At the open Commission meeting, Chairman Pitt indicated that the SEC would not preempt state law in this area.

There is a 30-day comment period for this proposal - the SEC is required to adopt final rules by January 26, 2003.

The proposing release is available at <http://www.sec.gov/rules/proposed/33-8138.htm>.

SEC VI: Proposed Rules on Improper Auditor Influence

In mid-October, as mandated under Section 303 of Sarbanes-Oxley, the SEC proposed rules that would prohibit officers or directors - or persons acting under their direction - from improperly influencing accountants. In the proposing release, the SEC included a non-exclusive list of conduct that could be deemed improper conduct.

At the open meeting, the Commission noted that this rulemaking was fairly superfluous - as Section 20(c) of the Securities Exchange Act of 1934 already allows the SEC to bring actions for the type of behavior that would be actionable under this proposal (including "attempts" to improperly influence accountants).

In the proposing release, the SEC intimates that a state of mind short of fraud might be enough to trigger a violation - and it is clear that scienter would not be required for the SEC to bring an action under this rule (particularly as the new will not create a private right of action). As a result, communications between an independent auditor and its clients will be under higher scrutiny. The SEC also indicates that this rule even applies after the end of an engagement - such as when an auditor issues a consent well after an audit is complete.

There is a 30-day comment period for this proposal - the SEC is required to adopt final rules by April 26, 2003.

The proposing release is available at <http://www.sec.gov/rules/proposed/34-46685.htm>.

SEC VII: Proposed NYSE and Nasdaq Rules on Stockholder Approval

of Option Plans

In early October, the SEC proposed revised NYSE and Nasdaq corporate governance listing standards that would require listed companies to obtain shareholder approval for most equity compensation plans - as well as prohibit brokers from voting uninstructed shares regarding these plans.

The SEC decided to "split out" these two matters from the overall broader corporate governance proposals forwarded by the NYSE and Nasdaq in late August. One reason for the "split-out" is that the NYSE's pilot program (that exempts stock option plans from shareholder approval requirements if a majority of the company's full-time employees are eligible to be awarded options - and if a majority of the shares are awarded to employees who are not officers and directors) will expire at the end of October.

Proposed exceptions to the shareholder approval requirement are employment inducement awards, plans relating to mergers and acquisitions, and ESOPs (Nasdaq also would except certain rights plans). However, inducement awards and tax-qualified plans would still be subject to approval by the company's compensation committee or a majority of the company's independent directors.

The comment periods ends November 1 for the NYSE proposal - and November 7 for the Nasdaq proposal.

The SEC's releases are at <http://www.sec.gov/rules/sro/34-46620.htm> and <http://www.sec.gov/rules/sro/34-46649.htm>.

Pension Blackout Periods: SEC and DOL Proposes Rules

Today, the SEC proposed rules under Section 306(a) of Sarbanes-Oxley prohibiting insiders from trading in their company's equity "acquired while in service as a director or officer." Exception for transactions under DRIPs, Rule 10b5-1 plans and other benefit plans (other than discretionary transactions) were included in the proposed rules.

Under the SEC's proposed rules, the trading prohibitions apply only if the blackout lasts longer than 3 business days - affects more than 50% of the employee base. In addition, for foreign private issuers, the formula is 50% of the employee base has to be in the U.S. - and then 15% of the entire employee base is affected by the blackout.

Like Section 16, there would be the possibility of an SEC action and private litigation for recovery of the insider's profits for rule violations.

Earlier, in mid-October, the U.S. Labor Department's Pension and Welfare Benefits

Administration published interim final rules implementing Section 306 of the Sarbanes-Oxley Act. These rules require companies with 401(k) -type plans to give participants 30-day advance notice of "blackout periods" - and for plan administrators to give a similar notice to companies (so that insiders can refrain from trading in the company's securities during the blackout period). The interim final rules are effective January 26, 2003.

The interim final rules contain model notice language to assist plan administrators in carrying out this new obligation. Failure to provide proper notice can trigger civil penalties for plan administrators of up to \$100 per day per participant.

These new interim rules are available at <http://frwebgate.access.gpo.gov/> and <http://frwebgate.access.gpo.gov>. The SEC has not yet posted its proposing release.

Public Company Accounting Oversight Board: Members Appointed

On October 25th, at one of the SEC's most contentious open meetings in recent memory, the Commission appointed the five members of the new Public Company Accounting Oversight Board. Under Section 101 of Sarbanes-Oxley, the SEC was required to establish this board by October 28th.

In a 3-2 vote, the Republican majority on the Commission selected former FBI and CIA director William Webster to chair the new board, with a term until 2007. The SEC's two Democratic Commissioners, Harvey Goldschmid and Roel Campos, claimed that Mr. Webster lacks the expertise to oversee the accounting industry. This followed earlier accusations by others that the accounting lobby effectively blocked former TIAA-CREF chairman John Biggs from being selected as chair.

The other board members appointed were:

Daniel Goelzer, a partner at **Baker & McKenzie** - who previously spent seven years as the SEC's General Counsel (term expires 2006).

Kayla Gillan, former general counsel of the **California Public Employees' Retirement system** (term expires 2005).

Willis Gradison Jr., a former Republican congressman who is Senior Public Policy Counselor at **Patton Boggs** (term expires 2004).

Charles Niemeier, the SEC's Chief Accountant in the Division of Enforcement and co-chairman of the Division's financial-fraud task force. Mr. Niemeier previously was a partner at **Williams & Connolly** (term expires 2003).

Commissioner Goldschmid voted against all 5 board members to protest the selection process and said that as far as he knew none of the board members approved had been properly vetted - and that he was not told their names until the morning before the meeting. Commissioner Campos dissented only to the choice of Chairman Webster.

After the SEC's appointments, according to the Washington Post, Senate Banking Committee Chairman, Paul Sarbanes (D-Md.) declared that "the country would be best served if Mr. Pitt stepped down." Others in the Democratic congressional leadership and Senator John McCain (R-Ariz.) had already recommended that Chairman Pitt resign or be fired.

The related SEC press release is at <http://www.sec.gov/news/press/2002-153.htm>. Commissioner Goldschmid's statement is at <http://www.sec.gov/news/speech/spch596.htm>. The October 26th Washington Post article regarding the meeting is at <http://www.washingtonpost.com/wp-dyn/articles/A19572-2002Oct25.html>.

Disclosure Controls and Procedures: What to Do Now, Part II

Our October 24th program on "Disclosure Controls & Procedures" resulted in a wealth of tidbits from panelists **Linda Griggs** of **Morgan Lewis & Bockius**, **John Huber** of **Latham & Watkins** and **Cary Klafter**, Director of Corporate Affairs and Senior Counsel at **Intel Corporation**. These tidbits included:

1. **Getting Started**

- better to add on to what you have than to start a new system - but in order to do that, you have to really go and find out what you have, document what information is being provided - and when and how timely that information is when it comes up.
- there are a diversity of approaches - and the two ends of this spectrum are companies in which the CEO and CFO get daily reports (so the policies and procedures may already be in place and the only thing that needs to be done is to formalize them) versus companies that are going to need to implement new procedures and are going to have to come to grips with the idea of the cost of those new procedures.

2. **Tone at the Top**

- the approach should reflect a high degree of integrity and have ethical values - so that it's clear that management really knows how to assign responsibilities, knows how to keep the board of directors involved.
- when documenting your disclosure controls and procedures, emphasize the commitment of management, including the CEO and the CFO, to complete, accurate and timely disclosure.
- make sure that the company's evaluation of personnel takes into account the employee's ethical conduct and their compliance with the disclosure controls and procedures in which they play a role.
- appointing a traffic cop who really monitors compliance with disclosure controls and procedures - and this person should have access to top

management and the board - and should have the adequate time and resources to make sure that disclosures are appropriate.

- consider a code of ethics that applies to everybody involved in the disclosure process - and probably want to incorporate by reference your code of ethics - and maybe even your insider trading policies and Regulation FD policies into the disclosure controls.
 - provide education as to the disclosure process so that everybody understands the process and understands the requirements of the securities laws.
3. **Disclosure Committee**
- The Commission's release does not specify what disclosure controls and procedures should be, but the Commission recommends that companies have disclosure committees.
 - the disclosure committee would be charged with receiving information that is accumulated, assigning responsibility for drafting reports or sections thereof, revising the drafts and making inquiries when it believes appropriate to assure itself of the disclosure's completeness and reliability - and really making the determinations concerning materiality, and requiring the disclosure obligations to be complied with on time. All this should be conducted in tandem with other players in the company, particularly the CEO with CFO and the audit committee.
 - the committee members should have the skills, experience and position to exercise judgment as to materiality and disclosure, and to monitor the disclosure process - and they should be available on a 24/7 basis to have meetings when they're required, and to be available when those meetings need to be done at any time.
 - in-house lawyers might serve as an advisor to the committee rather than be on the committee to preserve the attorney-client privilege.
 - should be flexible so that whatever you first put into place doesn't work, you basically throw it out and start with something different or amended
 - the old way of drafts being prepared somewhere in the bowels of the company is going to change - the drafting part is going to be far higher in the corporate hierarchy than it was before.
 - there's a divergence of opinion with respect to whether there should be a charter for the disclosure committee - but there should be written disclosure controls and procedures. They don't have to be the "tick and tie" detailed kind of things that the COSO standards have - but rather more principles-based.
 - in terms of the responsibilities, the disclosure committee should understand that they're really assisting the CEO, CFO in establishing and maintaining disclosure controls and procedures - and they're also consulting with the internal auditor regarding internal controls and with the finance people.
4. **Internal Controls**
- until the SEC's internal controls report proposing release came out this week, most of us thought that internal controls were a subset of disclosure

controls and procedures - but the release is inconsistent so there is some confusion

- we certainly need to worry about internal controls this time around - but in terms of going and looking very carefully at the way in which you have documented internal controls, perhaps you don't need to have a thorough analysis of your internal controls for this 10-Q.
- the SEC seems to suggest in the transition discussion - although, again, this is not extremely clear - that their proposal to require quarterly evaluations of internal controls for financial reporting won't be effective until after the first annual management report on internal controls.

5. **Information Flow**

- One of the debates among people who have been thinking about this area is - Is this a top-down approach? Or is this a bottom-up approach? "Top-down" meaning the senior people talk about trends and their vision, and they, in essence, transmit it down. The "bottom-up" approach is the real numbers and the details come up from the bottom.
- one view is that it's both top-down and top-up. Key decisions are made at the senior management and board level. Information about trends and strategy and competition are oftentimes their bailiwick. But having input from the people lower down is absolutely critical in the process, at least from my standpoint. And that's really where your numbers are coming from.
- One view is that it's both top-down and top-up. Key decisions are made at the senior management and board level. Information about trends and strategy and competition are oftentimes their bailiwick. But having input from the people lower down is absolutely critical in the process, at least from my standpoint. And that's really where your numbers are coming from.
- regarding backup certifications or sub-certifications, a number of people have suggested that the only way that people will take this process seriously is if they have to sign their name to it. That should be a supplement as opposed to a primary way of doing things and it goes to a corporate culture point.
- one way to sort of split the difference is to have heads of business units, for example, be responsible for getting information from their team. And the team members wouldn't give a sub-certification, wouldn't be asked to fill out questionnaires. But maybe the head of the business unit would, in fact, fill out a questionnaire or give a sub-certification.

6. **Evaluation of Disclosure Controls**

- there are really two kinds of monitoring - one is real-time monitoring of your disclosure controls and procedures. You've got to be taking into account changes in your business or personnel as well as any concerns or complaints that you hear about your disclosure controls and procedures and, of course, your internal controls when we do start monitoring those regularly.
- the other is the one-time evaluation - your evaluation should be as of the end of the period covered. For that one-time evaluation, you probably want to look first at how you've documented the process - and to specifically ask for comments on those. Make sure there's a corporate culture that recommends

that people bring to the disclosure committee's attention any concerns with the way the process works.

- you should also do a look-back - look back at your agenda and time and responsibilities calendar to make sure it worked.

Thanks to **Luis Roth** and the Paris office of **Linklaters**, you can review samples of recent disclosures regarding "disclosure controls" at

<http://www.realcorporatelawyer.com/Features/DisclosureControls.pdf>

Executive Compensation: The Conference Board's Commission Report

In mid-September, the Conference Board's Commission on Public Trust and Private Enterprise proposed wide-ranging reforms on executive compensation practices. The Conference Board Commission is comprised of notable business leaders and regulators - including former SEC Chairman Arthur Levitt and former Comptroller General Charles Bowsher.

The linchpin of the Commission's efforts is a series of recommended best practices, as supported by four guiding principles. These principles are:

1. **Pay for performance** - much tighter linkage between executive operating performance and executive compensation, such as compensation committees adopting specific policies to ensure that the company recaptures excessive incentive compensation from officers.
2. **Compensation committees** - that are fully independent, accountable, and vigorous, including committees hiring their own consultants, holding executive sessions and setting their own agendas.
3. **Accounting neutrality** - so as to avoid bias and favor any one form of equity-based compensation and, at the same time, facilitate comparability of results as between companies, including stock options being expensed on the financial statements for all companies (with a dissent from Commission member Andy Grove, Chairman of Intel) - and companies reporting the costs associated with equity-based compensation on a uniform and consistent basis. Commission member Paul Volcker issued his own dissent by urging the elimination of fixed options entirely.
4. **Full disclosure** - of all material information on an understandable and timely basis, including requiring officers to provide advance notice of their intention to dispose - directly or indirectly - company securities that they own (and compensation committees developing and disclosing appropriate methods by which disclosure of such intentions would be made). This would be a further expansion of the new Section 16 framework under which most insider trades are reportable to the SEC within 2 business days.

For more information about the Commission's recommended best practices, see the Commission's report at http://www.conference-board.org/PDF_free/756.pdf.

Loans: More on Evolving Positions

In an attempt to tackle the challenging interpretative issues that have arisen under Section 402 of the Sarbanes-Oxley Act of 2002, 25 law firms issued a position paper on October 15th. This paper was issued a few weeks after two senior Senators wrote a letter to SEC Chairman Harvey Pitt expressing their views that Section 402 was drafted with the intent to prohibit many of the types of arrangements that are addressed in the position paper (and are viewed as permissible under certain circumstances).

In the absence of guidance from the SEC staff - who are too burdened with a heavy rulemaking schedule to weigh in at this time - companies are left with plenty of gray areas and tough decisions on how much risk to bear. Among other areas, the 25 law firm memo addresses:

Various rationales to support interpretations of the key definitions of "personal loan" and "arrange"

Travel and relocation advances are generally permissible - so long as they are reasonable (with no interest) and settled by the employee through documentation.

Indemnification advances are generally permissible - due to well-developed and longstanding state policy interest in providing these advances; the business purposes behind these advances; and because (presumably even at the time an advance is made) the indemnified party is only contingently required to repay the company and the contingency makes the likelihood of such repayment reasonably uncertain.

Loans from 401(k) plan are generally permissible - because the economic consequences typically are officers borrowing from themselves and the 401(k) plan is the lender; not the corporate sponsor.

Loans from 401(k) plan are generally permissible - because the economic consequences typically are officers borrowing from themselves and the 401(k) plan is the lender; not the corporate sponsor.

To review the 25 law firm memo, see <http://www.realcorporatelawyer.com/loan25firms.pdf>. The letter from Senators Susan Collins and Carl Levin to Chairman Pitt is at <http://www.realcorporatelawyer.com/402letter.pdf>.

Ethics: ABA Presidential Task Force on Corporate Responsibility

Hearings

In March, the American Bar Association created a Presidential Task Force on Corporate Responsibility - and this Task Force issued a Preliminary Report on July 16th. After Sarbanes-Oxley was enacted with a provision (Section 307) requiring the SEC to conduct rulemaking regarding the professional standards for lawyers, a subcommittee of that Task Force then was assigned the responsibility of evaluating these standards.

The SEC is holding an open Commission meeting on November 6th to propose rules under Section 307. These rules promise to be among the more controversial rules proposed under Sarbanes-Oxley.

This subcommittee is conducting a series of three hearings on the Task Force proposed rule changes that impact professional responsibility standards. Among the proposed rules are ones that would:

- Require lawyers who know - or reasonably should know - of misconduct by corporate officers, employees or agents to disclose the misconduct to higher corporate authorities, in some cases directly to the board of directors. (Model Rule 1.13)

- Broaden permission for lawyers to disclose information about corporate conduct that has resulted in - or is reasonably certain to result in - substantial injury to the financial interests or property of another. (Note that the ABA House of Delegates rejected a similar proposal in February before the task force was created) (Model Rule 1.6)

The first hearing was held in Chicago on September 20th - and it provided an ample look at how controversial these proposed changes are. Some experts testified that the proposed modifications to these rules:

- are not appropriate for disciplinary rules with strict liability (and not the place for negligence standards)

- would undermine the lawyer's role because clients - knowing that they could be tattled on - would not speak freely

- would create conflicts because lawyers would in a sense be representing both the company and its investors (in comparison, independent auditors do properly have these dual roles)

- would undermine the attorney-client privilege, which is the bedrock of the legal profession

- would result in attorneys being added as co-defendants to every fraud lawsuit, with a huge impact on attorney malpractice insurance

Other testimony supports some or all of the Task Force's recommended changes. Read this interesting testimony at <http://www.abanet.org/buslaw.html>. The July 16th Preliminary Task Force Report is at <http://www.abanet.org/buslaw/.pdf>.

Corporate Governance: Directors Weigh In

In the 29th Annual Board of Directors Survey from **Korn/Ferry International** and **Corporate Board Member Magazine**, over 1000 directors gave their opinions, experiences and board practices. These directors were surveyed in early 2002.

Below are some of the results:

- 72% said CEOs should signoff on the accuracy of their company's financial statements
- 74% said former CEOs should not serve on the board
- 59% said the board should have a lead director
- 36% said board meetings should be held online occasionally (2% already have)
- the ideal board size was deemed to be 10 (2 insiders and 8 outsiders)
- 82% said a CEO's outside directorships should be limited (and 54% favored a cutoff for all directors)
- 71% have written guidelines on governance
- 40% regularly and formally evaluate board effectiveness
- 62% have a committee to review corporate governance and board practices
- 64% have a management succession committee
- 21% of boards evaluate individual directors regularly
- 59% stated a majority of director's compensation should be in equity
- 52% require that directors own stock
- 58% would like to diversify their boards with increased minority representation

More survey results from the 29th Annual Board of Directors Survey are available at <http://www.boardmember.com/network/index.pl>.

What's Up Online: More and Improved XBRL Filings

Microsoft Corp. and Morgan Stanley recently filed the first-ever EDGAR-filed documents containing "extractable" XBRL (eXtensible Business Reporting Language) with the SEC. By including XBRL encoded financials in their Form 8-Ks, these companies have allowed investors and analysts to use XBRL-aware applications to more easily manipulate and analyze the information in their financial statements. RR Donnelley Financial has assisted on all of these XBRL filings.

To review the XBRL filings, see <http://www.microsoft.com/msft/xbrlinfo.htm#New>. For more information about XBRL, see our FAQs at <http://www.realcorporatelawyer.com/XBRLFAQ.html>.

Comings and Goings: Who's Doing What and Where

At the SEC, the SEC's budget is overdue as the Democratic party and the White House are at odds over what amount of temporary funding the SEC should receive until Congress and the White House can decide on a final 2003 budget for the SEC.

Democrats, led by Senate Banking Committee Chairman Paul S. Sarbanes (D-Md.), want the SEC's final budget to be \$776 million in fiscal 2003 as set forth in Sarbanes-Oxley, a 77% increase from the \$438 million 2002 budget. The White House has wanted it to be \$568 million, a 30% increase.

According to the Washington Post, the 2003 fiscal year began October 1st, but Democrats and Republicans failed to reach a budget agreement - so Congress passed a continuing resolution to temporarily fund the federal government at 2002 levels. However, the continuing resolution could continue to determine the SEC's funding level well into 2003. The SEC has indicated that it can operate at 2002 budget levels for a few months - but that it would stretch its resources as it starts up the new Public Company Accounting Oversight Board (in addition to other new duties).

To see the October 21st Washington Post article on this budget problem, see <http://www.washingtonpost.com/wp-dyn/articles/A61692-2002Oct21.html>. The SEC's 6th Rate Advisory - which states that existing fee rates continue until a new budget is passed - is at <http://www.sec.gov/news/press/2002-152.htm>.

In **Corp Fin**, **Gerald Laporte** has been named the head of the Office of Small Business Policy. Gerry was a partner at Hogan & Hartson in Washington DC. **Grace Lee** has joined the Chief Counsel's office and will lead the Shareholder Proposal Task Force for the 2003 proxy season. **Sarah Hirsh** has been promoted to Special Counsel in the Office of Transportation & Leisure.

Amy O'Brien has left the Office of International Corporation Finance to join Freddie Mac.

Events Calendar

Upcoming events of interest include:

Financial Executive Institute's "Integrity IN the Bottom Line," New York City, November 4-5

PLI's "34th Securities Law Institute," New York City, November 6-9 (also available by videoconference in San Francisco or by webcast to your computer)
American Bar Association's Litigation Section and the University of Toledo's "2002 Cybersecurities Forum," Washington D.C., November 12
CPE's "2002 SEC Conference," Phoenix, November 18-19
(<http://www.cpeonline.com/sec/overview.asp>)
American Society of Corporate Secretaries "Annual Issues Update," New York City, November 21
Western Institute for Corporate Governance's "2002 Directors' Institute," Scottsdale, November 21
American Bar Association's Committee on Federal Regulation of Securities' "Fall Committee Meeting," Washington, D.C., November 22-23
Northwestern Law's "41st Annual Corporate Counsel Institute," San Francisco, December 5-6 (<http://www.law.northwestern.edu/contexec>)
Glasser's Institute of Directors Conference on Corporate Responsibility, London, December 5 (<http://www.legalwks.com/conferences/cr/index.htm>)
National Association of Corporate Directors' "Role of the Governance Committee: Raising The Bar," Washington D.C., December 10
PLI's "London Institute," London, December 9-10
Glasser's "24th Annual Institute on Proxy Statements, Periodic Reports, and Critical Disclosure Issues," San Francisco, December 9-10, New York City, December 11-12 (<http://www.legalwks.com/conferences/proxy/index.htm>)
Northwestern Law's "30th Annual Securities Regulation Institute," San Diego, January 29-31
(<http://www.law.northwestern.edu/depts/contexec/cle/securities/index.htm>)

Input, Please

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