

Sarbanes-Oxley Act of 2002:

A Changing World for Accounting, Executive Compensation and Benefits

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Discussion Topics Include:

- **New responsibilities for CEOs and CFOs**
- **Establishment of Public Company Accounting Oversight Board**
- **New roles for audit committees and auditors**
- **Impact on retirement plans**
- **Effect on officer and director compensation and benefits**
- **Potential future effect on trust funds**
- **Practical suggestions for compliance**

New Responsibilities For CEO's and CFO's

- **Certify financial statements**
- **Faster reporting of securities transactions**
- **Report on internal control**
- **Disclosures regarding financial statement changes**
- **Criminal penalties for defrauding shareholders**
- **Disclose material off balance sheet transactions**
- **Trading during blackout periods**

Public Company Accounting Oversight Board (POB)

Duties

- **Oversee audit of public companies**
- **Establish audit report standards and rules**
- **Investigate, inspect and enforce compliance**

Question 1

The Public Oversight Board will improve corporate trust fund accounting and auditing.

- A. Strongly agree with this statement**
- B. Agree with this statement**
- C. Neutral regarding this statement**
- D. Disagree with this statement**
- E. Strongly disagree with this statement**

Public Company Accounting Oversight Board (POB) (Continued)

Other Applicable Provisions

- **5 members; no more than 2 CPAs**
- **Registration by firms within 180 days**
- **Can impose disciplinary or remedial actions**
- **SEC has oversight of Board**

Key Provisions for Audit Committees

- **Must approve all audit and non-audit services**
- **Auditors must report alternative accounting treatments**
- **Hires, decides compensation, oversees auditor**
- **Must have one financial expert**
- **Members must be independent**

Key Provisions for Auditors

- **Prohibits specified non-audit services**
- **Mandatory partner rotation**
- **Restrictions on accepting client employment**
- **Audit firms pay for POB**

Key Provisions for Auditors

(Continued)

- **Penalties for failure to supervise**
- **Maintain working papers for specified period**
- **Second partner review**
- **Attest to management's assessment internal control**

Prohibited Services for Auditors

- **Bookkeeping**
- **Financial information system design and implementation**
- **Appraisal or valuation services**
- **Actuarial services**

Prohibited Services for Auditors

(Continued)

- **Internal audit services**
- **Management functions or human resources**
- **Investment services**
- **Legal or expert services**

Question 2

Trustees will resist higher audit costs.

- A. Strongly agree with this statement**
- B. Agree with this statement**
- C. Neutral regarding this statement**
- D. Disagree with this statement**
- E. Strongly disagree with this statement**

Potential Effect on Trust Funds

- **Audits that cost more**
- **Auditor has less flexibility**
- **Auditor spends more time on fraud**
- **Seek accounting services from others**
- **Greater use of audit committee**
- **Trustees held to higher standards**

Potential Effect on Trust Funds

(Continued)

- **Increased participant rights**
- **More trustee education required**
- **Higher fiduciary liability insurance premiums**
- **Decreasing pool of auditors**
- **Potential trustees may say “no”**

Question 3

CPAs should have greater responsibility for detecting fraud.

- A. Agree**
- B. Disagree**
- C. No opinion**

Practical Suggestions for Compliance

- **Set up audit committee**
- **Consider trustee certification of financial statements**
- **Restrict non-audit services**
- **Obtain certifications from employees**
- **Better education for trustees and participants**
- **Be skeptical**

Question 4

What will be the biggest impact of the Sarbanes-Oxley Act?

- A. Responsibility taken by corporate executives**
- B. Responsibility taken by auditors**
- C. Improvements in retirement plans**
- D. More audit committees for employee benefit plans**

Impact on Qualified Retirement Plans and Executive Compensation

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Issuer

- **Issuer of securities that:**
 - **Is registered under section 12 of the Securities Exchange Act of 1934 (the Exchange Act)**
 - **Is required to file reports under section 15(d) of the Exchange Act**
 - **Files a registration statement not yet effective under the Securities Act of 1933 and that has not been withdrawn**

Qualified Plans

- **Plan Loans**

- **Act includes loan prohibitions**

- **issuer may not directly or indirectly**

- **in the form of a personal loan -**

- **extend or maintain credit**

- **arrange for an extension of credit**

- **renew an extension of credit**

- **to directors or executive officers**

Qualified Plan Loans

- **Arguments against treating plan loans as subject to loan prohibition:**
 - **Participant borrowing from his own account**
 - **Existing ERISA requirements**
 - **exclusive benefit rule**

Prohibition of Insider Trades During Blackout Period

- **General Prohibition**
 - Issuers' Directors or executive officers may not trade securities during any blackout period
- **Penalties**
 - If trading occurs during a blackout period:
 - Any profit realized belongs to the issuing company
 - Issuing company may sue to recover profits
 - Any shareholder may file suit if company fails to file suit

Prohibition of Insider Trades During Blackout Period (cont.)

- **Blackout Period**
 - **Period exceeding 3 consecutive business days during which plan participants are temporarily suspended, limited or restricted from:**
 - **Directing or diversifying assets**
 - **Obtaining plan loans**
 - **Obtaining distributions**
 - **Exception**
 - **Individual restrictions due to QDROs**

Notice Requirements to Participants and Beneficiaries

- **Duties of Plan Administrator**
 - **Provide notice to affected participants and beneficiaries**
 - **Provide notice to issuer of securities subject to a blackout period**

Notice Requirements to Participants and Beneficiaries (cont.)

- **Notice Requirements**

- **In writing:**

- **may be provided electronically or in any other form reasonably accessible to the recipient**
 - **Notice deemed made as of date of mailing or electronic transmission**

- **Understandable by average plan participant**

Notice Requirements to Participants and Beneficiaries (cont.)

- **Notice must contain:**
 - **Reasons for the blackout period**
 - **Identification of the investment and other rights affected**
 - **Expected beginning date and ending date of the blackout period**
 - **Statement that participant should evaluate current investment election in light of temporary inability to make changes**

Notice Requirements to Participants and Beneficiaries (cont.)

- **Timing of Notice**

- **At least 30 and**
- **No more than 60 calendar days**
- **Prior to the last day rights may be exercised immediately before the start of the blackout period**

Notice Requirements to Participants and Beneficiaries (cont.)

- **Model Notice**
 - Model notice issued by Department of Labor
 - Model intended to satisfy most notice requirements
- **Civil Penalties for Failure to Provide Notice.**
 - Up to \$100 per day/per participant
- **Effective Date**
 - January 26, 2003

Question 5

The blackout provisions impose an unreasonable burden on plan administrators.

- A. Strongly agree with this statement**
- B. Agree with this statement**
- C. Neutral**
- D. Disagree with this statement**
- E. Strongly disagree with this statement**

Executive Compensation

- **Loan Prohibitions**
 - Lack of defined terms
 - Lack of pre-enactment legislative history
 - Conflicting post-enactment statements of intent
 - Significant impact on ordinary employment related transactions
 - Lack of SEC guidance
- **Civil and Criminal Sanctions**

Loan Prohibition

- **An issuer may not directly or indirectly extend or maintain credit, arrange for the extension of credit, or renew an extension of credit**
- **In the form of a personal loan**
- **To a director or executive officer (or equivalent thereof)**

Loan Prohibition

- **Exceptions to Loan Prohibition**
 - **In the ordinary course of business**
 - **of a type generally made to the general public**
 - **on market terms**

Grandfathered Loans

- **Maintained on July 30, 2002**
 - **No material modification**
 - **No renewal**
 - **What is a loan in place on July 30, 2002?**
 - **What is a material modification?**

Directors and Executive Officers (or the Equivalent)

- **Terms not defined**
 - **included in new Section 13(k) of the Exchange Act**
 - **reasonable to apply definition of “executive officer” found in Rule 3b-7 under the Exchange Act**
 - **Specific positions**
 - **any other policy making officer**
 - » **may include officers of subsidiaries who perform policy making for the issuer**

Loan Prohibitions

- **Arrange for an extension of credit**
 - **loan guarantees**
 - **arranging favorable loan terms**
 - **hidden extensions of credit in ordinary compensation arrangements**

Loan Prohibitions

- **Hidden extensions of credit:**
 - **travel advances**
 - **employment tax advances upon option exercise, restricted stock vesting, etc.**
 - **Business expenses subject to repayment:**
 - **personal use of company credit cards**
 - **personal use of company car**
 - **relocation payment**
 - **stay/retention bonuses**

Loan Prohibitions

- **Hidden extensions of credit:**
 - **Stock Options**
 - **cashless exercise**
 - **settlement of exercise price and tax withholding obligation occurs after exercise date**
 - **delivery of shares prior to or after settlement**
 - **company provides broker for cashless exercise**
 - **alternatives to cashless exercise**

Loan Prohibitions

- **Hidden extensions of credit:**
 - **Deferred Compensation Plans**
 - executives “invest” deferred compensation in notional accounts
 - company provides unsecured promise to pay a benefit based on a formula

Loan Prohibitions

- **Hidden extensions of credit:**
 - **Split dollar life insurance**
 - recent IRS guidance characterizes collateral split dollar as a loan from employer to employee for tax purposes
 - Schumer statements that split dollar loans intended to be covered by the Act
 - Alternatives
 - insurers providing grace periods for premium payment
 - restructure policies to paid-up status (with reduced benefits) - eliminate future premiums

Question 6

The loan prohibitions will be effective in preventing excessive compensation to officers and directors.

- A. Strongly agree with this statement**
- B. Agree with this statement**
- C. Neutral**
- D. Disagree with this statement**
- E. Strongly disagree with this statement**

Question 7

What topic would you like to see covered in a future teleweb?

- A. More on the Sarbanes-Oxley Act**
- B. More on executive compensation**
- C. Financial planning**
- D. Sales compensation**
- E. Health care costs**