



CLIENT ALERT

August 2, 2002

SARBANES-OXLEY ACT NEW AUDIT COMMITTEE REQUIREMENTS

The Sarbanes-Oxley Act of 2002 was approved by both houses of Congress and signed into law by President Bush on July 30, 2002. This Client Alert provides steps which should be taken by public companies to ensure that their audit committee activities are in compliance with the new law.

I. Amend Audit Committee Charter:

By April 26, 2003, the national securities exchanges and national securities associations are required to adopt rules requiring that audit committees comply with the requirements of the Act. Note that the New York Stock Exchange and the Nasdaq Stock Market have each adopted separate audit committee rules, which are awaiting approval by the SEC; however, these proposed rules may need to be updated based on the requirements of the Act. Once SEC approval of these rules is obtained, companies should amend their audit committee charter to state that:

- The audit committee is directly responsible for the appointment, compensation and oversight of the company's auditors (including the resolution of disagreements between management and the auditor regarding financial reporting);
- The company's auditor shall report directly to the audit committee;
- Each member of the audit committee must be a member of the company's board of directors and shall be "independent". To qualify as "independent", the audit committee member may not receive any consulting or other fees other than board, audit committee or other committee fees. Moreover, the member may not be an affiliated person of the company or its subsidiaries.
- The audit committee shall establish procedures for the receipt, retention and treatment of complaints received by the issuer regarding accounting, internal accounting controls, or auditing matters; and the confidential anonymous submission by employees of the issuer of concerns regarding questionable accounting or auditing matters;
- The audit committee has the authority to hire independent counsel and other advisers to carry out its duties.

The Act also requires the SEC to adopt a rule directing the national securities exchanges and national securities associations to prohibit the listing of any security of any company that is not in compliance with the above provisions.

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II. Review Audit Committee Staffing:

Due to the new independence standards imposed by the Act, companies must review the staffing of its audit committee so that they are in compliance with SEC rules as soon as such rules are adopted. Under the new rules, members of the audit committee may not receive any consulting or other fees other than board, audit committee or other committee fees. In addition, a member may not be an affiliated person of the company or any of its subsidiaries.

No later than January 26, 2003, the SEC is required to adopt rules requiring a company to disclose whether its audit committee has at least one member who is a "financial expert." This term was not defined by the Act, but will be defined by the SEC no later than January 26, 2003.

III. Discuss New Responsibilities and Duties with Audit Committee:

Management should review the new responsibilities and duties imposed on audit committees with the members of its audit committee as soon as possible.

We will be preparing a sample presentation to the Audit Committee of these new responsibilities and duties, as well as those imposed under the new NYSE and NASDAQ rules as they are finalized.

IV. Additional Considerations :

A. *Audit Committee to Establish Complaint Channels:* As soon as the SEC adopts rules requiring company compliance with the Act (no later than April 26, 2003), audit committees will be required to establish procedures for the receipt, retention and treatment of complaints received by the company regarding accounting, internal accounting controls or auditing matters. The audit committee must also establish procedures for the confidential, anonymous submission by employees of concerns regarding questionable accounting or auditing matters. Companies should begin considering the procedures and policies that will be put into place in order to come into compliance with this rule.

B. *Whistleblower Protection:* Effective immediately, a company may not discharge, demote or otherwise discriminate against any employee who lawfully provides information regarding any conduct the employee reasonably believes constitutes a violation of the securities laws or financial fraud statutes to (i) any governmental authority, (ii) by testimony or otherwise in any proceeding pending or about to be commenced concerning such a violation or (iii) to any person with supervisory authority over the employee or authorized by the company to investigate such conduct.

C. *Audit Committee Authorized to Engage Independent Counsel:* As soon as the SEC adopts rules requiring company compliance with the Act (no later than April 26, 2003), companies must grant their audit committees authorization to engage independent counsel and other advisers as the committee deems necessary to carry out its duties. The companies must provide appropriate funding, as the committee deems necessary to compensate the independent auditor and any advisors retained by the committee.

If you have questions regarding the impact of the Sarbanes-Oxley Act on audit committee activities, please contact David Fine, Christopher Klem, Keith Higgins or your regular Ropes & Gray contact.