

Business Update

SEC Adopts New Disclosure Requirements for Audit Committee Financial Experts and Code of Ethics

As required by the Sarbanes-Oxley Act, the SEC has adopted final rules requiring two new disclosures that must be included in a reporting company's annual report on Form 10-K or Form 10-KSB. The new items require that a reporting company disclose:

- Whether it has an "audit committee financial expert" serving on its audit committee, the name of the expert, and whether the expert is independent of management. A company that does not have an audit committee financial expert must disclose this fact and explain why it has no such expert.
- Whether it has adopted a code of ethics that applies to the company's principal executive officer, principal financial officer, principal accounting officer, controller, or persons performing similar functions. A company that has not adopted such a code must explain why it has not done so. Companies are also required to promptly disclose amendments to, and waivers from, the code of ethics relating to any of such officers.

Compliance Dates

Audit Committee Financial Expert Disclosures: Companies that are not small business issuers must comply with the audit committee financial expert disclosure requirements beginning with annual reports for fiscal years ending on or after July 15, 2003. Small business issuers must comply beginning with annual reports for fiscal years ending on or after December 15, 2003.

Code of Ethics Disclosures: All companies must comply with the code of ethics disclosure beginning with annual reports for fiscal years ending on or after July 15, 2003.

Audit Committee Financial Experts Disclosure

General: Under the new rules, a company must disclose that its board of directors has determined that the company either does or does not have at least one audit committee financial expert serving on its audit committee. A company that does not have an audit committee financial expert must explain why. If a company discloses that a member of its audit committee is an audit committee financial expert, it also must disclose the expert's name and whether that person is independent. It is not necessary, however, to disclose the names of more than one audit committee financial expert.

Definition of "Audit Committee Financial Expert": The final rules define an "audit committee financial expert" as a person who has the following attributes:

- An understanding of generally accepted accounting principles and financial statements;
- The ability to assess the general application of such principles in connection with the accounting for estimates, accruals and reserves;
- Experience preparing, auditing, analyzing or evaluating financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of issues that can reasonably be expected to be raised by the company's financial statements, or experience actively supervising one or more persons engaged in such activities;
- An understanding of internal controls and procedures for financial reporting; and
- An understanding of audit committee functions.

A person must have acquired such attributes through any one or more of the following:

- 1) Education and experience as a principal financial officer, principal accounting officer, controller, public accountant or auditor or experience in one or more positions that involve the performance of similar functions;
- 2) Experience actively supervising a principal financial officer, principal accounting officer, controller, public accountant, auditor or person performing similar functions;
- 3) Experience overseeing or assessing the performance of companies or public accountants with respect to the preparation, auditing or evaluation of financial statements; or
- 4) Other relevant experience. (Reliance upon "other relevant experience" also requires that a brief description of the relevant experience be disclosed.)

Although not part of the rules, the SEC points out that the fact that a person has experience as a public accountant, auditor, principal financial officer, controller or principal accounting officer or in a similar position does not, by itself, justify the board of directors deeming the person to be an audit committee financial expert. In addition to determining that a person possesses an appropriate degree of knowledge and experience, the SEC suggests that the board should ensure that it names an audit committee financial expert who embodies the highest standards of personal and professional integrity. In this regard, the SEC states that a board should consider any disciplinary actions to which a potential expert is or has been subject in determining whether that person would be a suitable audit committee financial expert.

Protection from Additional Liability for Audit Committee Financial Experts: The SEC addressed concerns that the designation or identification of a person as an audit committee financial expert might subject such person to additional liability or otherwise affect his or her duties or obligations as an audit committee member by including a provision in the new rules that specifically rejects these possibilities. In adopting this provision, the SEC emphasized that State law generally imposes a fiduciary duty upon directors to protect the interests of a company's shareholders and that the designation of a person as an audit committee financial expert is not intended to alter his or her duties, obligations or liabilities under State law.

Code of Ethics Disclosure

General: The new rules require a reporting company to disclose whether or not it has adopted a code of ethics for its principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions, and, if it has not adopted such a code of ethics, to explain why it has not done so.

Scope of Code of Ethics: The new rule defines the term "code of ethics" as written standards that are 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;
- Full, fair, accurate, timely, and understandable disclosure in reports and documents that a registrant files with, or submits to, the Commission and in other public communications made by the registrant;
- 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.

At a minimum, a company's code of ethics should address the foregoing matters. However, the SEC strongly encourages companies to adopt codes that are broader and more comprehensive than necessary to meet the minimum requirements.

The SEC believes that codes of ethics do, and should, vary from company to company and that decisions as to the specific provisions of the code, compliance procedures and disciplinary measures for ethical breaches are best left to the company. Therefore, the rules do not specify every detail that the company must address in its code of ethics, nor do they prescribe any specific language that the code of ethics must include. In addition, the rules do not specify the procedures that the

company should develop, or the types of sanctions that the company should impose, to ensure compliance with its code of ethics.

A company may have separate codes of ethics for different types of officers. Also, the provisions of the company's code of ethics that address the elements listed above that applies to the principal officers may be part of a broader code that addresses additional issues or applies to additional persons, such as all executive officers and directors of the company.

Codes of Ethics to Be Made Publicly Available: The rules require that a company make its code of ethics publicly available in one of three ways:

- A copy of the code of ethics may be filed as an exhibit to the company's Form 10-K or 10-KSB (which may be incorporated by reference from its proxy or information statement on Schedule 14A or 14C);
- The text of the code of ethics may be posted on the company's website, provided however, that a company choosing this option must also disclose its website address and intention to provide disclosure in this manner in its Form 10-K or 10-KSB; or
- A company may provide an undertaking in its Form 10-K or 10-KSB to provide a copy of its code of ethics to any person without charge upon request.

Disclosure of Amendments and Waivers: The new rules also require a company to disclose any change to, or waiver from, the company's code of ethics applicable to its principal officers. Specifically, the rules require disclosure of:

- The nature of any amendment to the company's code of ethics that applies to its principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions; and
- The nature of any waiver, including an implicit waiver, from a provision of the code of ethics granted by the company to one of these specified officers, the name of the person to whom the company granted the waiver and the date of the waiver.

A "waiver" is defined as the approval by the company of a material departure from a provision of the code of ethics. An "implicit waiver" occurs when the registrant fails to take action within a reasonable period of time regarding a material departure from a provision of the code of ethics that has been made known to an executive officer of the company.

Amendments and waivers can be disclosed on Form 8-K or via website dissemination of the information. A company choosing to provide the required disclosure on Form 8-K must do so within five business days after it amends its code of ethics or grants a waiver. As an alternative to reporting this information on Form 8-K, a company may use its website as a method of

disseminating this disclosure, but only if it previously has disclosed in its most recently filed Form 10-K or 10-KSB:

- its intention to disclose these events on its website, and
- its website address.

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