



Corporate Governance

Stephen L. Sapp
Locke Liddell & Sapp LLP

Southern Methodist University
Edwin L. Cox School of Business
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Sources Of New Laws, Rules And Regulations

- n Sarbanes-Oxley Act of 2002
- n Rule-making by SEC
- n Rule-making by NYSE/NASDAQ



Who Is Affected By These Laws?

n Public Companies

- Foreign private issuers
- Debt registrants
- IPOs

n Officers/Directors of Public Companies

n Auditors for Public Companies

n Attorneys for Public Companies (in-house/outside)



New Laws Do Not Apply To

- n Private Companies
 - n Non-profit corporations/Foundations
 - n Affiliates of such entities
- *Caveat:* Enhanced penalties for violations of securities laws, mail and wire fraud, and other white collar offenses.



Board Of Directors And Committees

n Role of Board of Directors

- Increased Scrutiny
- Increased Time Commitment
- Trends in Board Compensation

n Composition of Board of Directors

- Independence
- Executive Sessions
- Concept of Lead Director
- Trends in Board Composition



Board of Directors and Committees Cont'd.

n Audit Committee

- Heightened Independence
- Enhanced Role/Duties – Review Charter
 - Ø Appointment, compensation and oversight of auditor
 - Ø Establish procedure to address complaints for questionable accounting or audit matters
 - Ø Authority to engage advisors
- Financial Expert



Board of Directors and Committees Cont'd.

n Other Committees

- Nominating/Corporate Governance Committee
- Compensation Committee
- Independence Requirements
- Review Charter Documents



Accelerated Disclosure Cont'd. (Periodic Reporting)

n Accelerated Filing requirements

For Fiscal Years Ending on or after	Form 10-K Deadline	Form 10-Q Deadline
December 15, 2002	90 days after fiscal year end	45 days after fiscal quarter end
December 15, 2003	75 days after fiscal year end	45 days after fiscal quarter end
December 15, 2004	60 days after fiscal year end	40 days after fiscal quarter end
December 15, 2005	60 days after fiscal year end	35 days after fiscal quarter end



Accelerated Disclosure Cont'd.

n Section 16 Reporting

- Effective August 29, 2002, any change in beneficial ownership by a director, executive officer or 10% shareholder must be reported before the end of the second business day following the date on which the transaction was executed.
- This applies to transactions previously reported on Form 4, and to transactions with the issuer that were previously reported on Form 5.



Accelerated Disclosure Cont'd. (Section 16 Reporting)

- n Limited exception – the insider does not control the date of execution (*i.e.* transactions pursuant to 10b-5(1) plans and certain employee benefit plans)
 - Date on which the insider receives notice of the transaction is deemed the date of execution
 - Notice date cannot be more than 3 business days following the trade date.



Accelerated Disclosure Cont'd. (Section 16 Reporting)

- n Electronic filing and availability – no later than July 30, 2003
 - Section 16 reports to be filed by EDGAR
 - Website access within 1 business day of filing

- n Impact of failure to comply
 - Disclosure in proxy statement
 - Administrative action by SEC

- n Compliance Procedures



Accelerated Disclosure cont'd.

n SEC Proposals for Form 8-K

- Additional Disclosure Items
 - ∅ Directors/Officers – appointment, resignation, termination
 - ∅ Accounting matters – restructuring charges, impairment, material obligations
 - ∅ Listing Status/Rating Agency Decisions
 - ∅ Transactions in Securities – Application to 10b-5(1) Plans
- Accelerated Disclosure



Enhanced Disclosure

- n Disclosures in Periodic Reports
 - Pro Forma Financial Information
 - Off-Balance Sheet Transactions
 - Final rules from SEC on or before January 26, 2003

- n Management Assessment of Internal Controls

- n Code of Ethics for Senior Financial Officers
 - Disclosure in Form 10-K
 - Disclosure of changes/waivers on Form 8-K
 - Proposed Rules by October 28, 2002 and final rules by January 26, 2003

- n Audit Committee Financial Expert

- n Enhanced SEC Review



Other Provisions of Sarbanes-Oxley Act

- n Forfeiture of certain profits/bonuses by CEO or CFO
- n Officer/Director bars and penalties
- n Rotation of Audit Partners and Conflict of Interest
- n Prohibition of insider trades during pension blackout periods
- n Rules of Professional Conduct for Attorneys



Other Provisions of Sarbanes-Oxley Act Cont'd

- n Securities fraud claims – not dischargeable in bankruptcy
- n New criminal provisions – destruction of documents/retention of work papers
- n Enhanced criminal penalties – prison terms, fines and expanded statute of limitations
- n Enhanced whistleblower protection
- n Additional funding for SEC



PRACTICAL CONSIDERATIONS

- n What can a director or executive officer do to protect themselves?
 - Understand the Law/Act Prudently
 - Structural Protections
 - Ø D&O Coverage
 - Ø Indemnification
 - Asset Protection
 - Ø Partition
 - Ø Family limited partnerships
 - Ø Other strategies



Sec 202—Preapproval Requirements

- n “All auditing services and non-audit services . . . provided to an issuer by the auditor of the issuer shall be preapproved by the audit committee of the issuer.”



Sec 204—Auditor Reports to Audit Committee

- n All critical accounting policies and practices “to be used”
- n Alternative treatment of financial information discussed with management (and auditor’s preferred treatment)
- n Other written communications between management and the auditor (management reports, schedule of unadjusted errors, etc.)



Sec 302—Corporate Responsibility for Financial Reports

- n Principal Executive and Financial Officers—
- n Have reviewed report
- n Does not contain an untrue material fact or omit a material fact
- n Presents fairly in all material respects the financial conditions and results of operations



Sec 302—Corporate Responsibility for Financial Reports

- n Principal Executive and Financial Officers—
- n Establish and maintain disclosure controls (wider than internal controls)
- n Ensure material information is made known to them
- n Evaluate system within last 90 days
- n Present their conclusions regarding the effectiveness of disclosure control system



Sec 302—Corporate Responsibility for Financial Reports

- n Principal Executive and Financial Officers—
- n Address financial information in its entirety
- n Have disclosed to auditor and audit committee
 - Significant deficiencies in internal controls
 - Any fraud involving person with significant role in internal control



Sec 303—Improper Influence on Conduct of Audits

- n “It shall be unlawful. . . for any officer or director of an issuer, or any other person acting under the direction thereof, to take any action to fraudulently influence, coerce, manipulate, or mislead any independent public accountant . . . In the performance of an audit of the financial statements of that issuer. . .”



Sec 404—Management Assessment of Internal Control

- n Management is required to report on—
 - Its responsibility for establishing and maintaining adequate internal control structure and procedures for financial reporting (becomes a subset of the reporting controls addressed in Sec 302)
 - Its assessment of the internal control structure and procedures
- n Auditor (as part of audit) will report on management's assessment



Sec 406—Code of Ethics for Senior Financial Officers

- n Issuer “to disclose whether or not, and if not, the reason therefor, such issuer had adopted a code of ethics for senior financial officers”

A golden scale of justice sits atop a classical column pedestal. The background is a soft, ethereal blue and white light. The scales are in shadow, while the pedestal is brightly lit from below.

Sec 406—Code of Ethics for Senior Financial Officers

- n Code of ethics to promote—
- n Honest and ethical conduct (including conflicts)
- n Full, fair, accurate, timely and understandable disclosure
- n Compliance with applicable governmental rules and regulations.



Sec 407—Disclosure of Audit Committee Financial Expert

- n Issuer “to disclose whether or not, and if not, the reasons therefor, the audit committee of that issuer is comprised of at least 1 member who is a financial expert . . .”



Sec 407—Disclosure of Audit Committee Financial Expert

- n Expert is defined as person who—
- n Understands generally accepted accounting principles and financial statements
- n Experience in—
 - Preparing or auditing financial statements
 - Applying generally accepted accounting principles
- n Experience with internal accounting controls
- n Understands audit committee functions



Equity Incentive Plans

- n Average “Overhang” – S&P 500 – is 14.3%
- n This “average” exceeds many institutional shareholder guidelines



NYSE Rules: Stockholder Approval of Equity Plans

- n Require approval of all plans
- n Definition of “plan” – Exclusions
 - Grants to new hires
 - M&A transactions: assuming a target’s existing plans (NYSE rules, not NASDAQ)
- n Elimination of Broker “Routine” Proxy Voting



CEO and CFO Forfeiture Provisions in the Sarbanes-Oxley Act

- n Trigger event: a restatement of earnings, based on “misconduct”
- n Forfeiture of bonuses, profits on stock sales during the year following



What Does the Sarbanes-Oxley Act Prohibit as “Loans to Executive Officers”?

- n “Cashless” exercises of options through captive brokers
- n Advances for personal expenses, subject to routine reimbursement procedures
- n New split-dollar life insurance coverage
- n Use of company credit cards



What is the Scope of the Loan Prohibition?

- n **OK: Existing loans, if not amended or extended**
- n **Probably OK: Routine 401(k) Plan loans, under tax-qualified rules**
- n **Prohibited:**
 - n “Arranging for credit,” even if indirectly
 - n Customary relocation loans



Board Compensation Issues

- n Additional fees for committee service
- n Compensation for additional responsibilities
– particularly audit committee service