Paul | Weiss

July 2002

U.S. Congress Passes Accounting Reform and Corporate Governance Legislation

The U.S. Congress has passed legislation that amends the U.S. securities laws in significant ways and establishes a new regulatory regime for accounting firms that audit public companies. The legislation, referred to as the Sarbanes-Oxley Act of 2002, was signed by the President July 30. The Act includes provisions that apply to public companies, as well as to the accounting firms that audit them (referred to in this memorandum as "auditors"). Auditors will now be required to register with a new Public Company Accounting Oversight Board in order to conduct such audits.

Certain provisions of the Act become law upon signature or within a specified period after enactment. Other provisions direct the SEC to adopt within specified periods rules (or final rules) with respect to the subject matter of such provisions. In yet other circumstances, the provisions are effective except to the extent the SEC excludes persons or conduct from coverage. Thus, the implications of the legislation will not be fully known until the SEC proposes and then promulgates rules in a variety of areas. Thereafter, to the extent standards and other provisions remain undefined, the full implications may only be clear as matters are raised and addressed in interpretive releases or litigation and enforcement actions.

This memorandum provides an overview of the changes that will result from enactment of the Act. We will be circulating future updates as provisions of the Act are clarified by rulemaking or otherwise. In addition, in connection with a program for clients that we will be presenting in early September, we will be circulating, among other things, model charters for board committees, a model corporate governance policy, a model code of business ethics, an updated securities trading policy and a memorandum on suggested procedures for officer certifications.

Coverage of the Act

The Act generally applies to companies (referred to in this memorandum as "public companies") that are required to file periodic reports under the Securities Exchange Act of 1934 (the "Exchange Act") or that have filed a registration statement under the Securities Act of 1933 (the "Securities Act") that has not yet become effective and that has not been withdrawn (i.e., a company that has filed a registration statement to go public but has yet to go public). The term public company thus covers privately held companies with public debt (including high yield debt issued under Rule 144A and subject to a registered exchange offer).

We distinguish "public companies" in this memorandum from companies that have a reporting obligation under Section 13(a) or 15(d) of the Exchange Act, which are referred to "reporting companies" and companies that are listed in the United States (e.g., excluding companies with only public debt), which are referred to as "listed companies."

It is unclear how the provisions of the Act will affect non-U.S. issuers listed, or seeking to access the capital markets, in the United States. In spite of the potential conflict with local rules and practices (to which the SEC and the stock exchanges have often deferred in matters of corporate governance), the Act appears to cover such companies, and understanding the ultimate effect will have to await SEC rulemaking contemplated by certain provisions of the Act.

Highlights

Among other things, the Act:

- treats companies in registration as public companies for purposes of many of the provisions of the Act;
- prohibits auditors from providing to their audit clients various specified non-auditing services;
- imposes a requirement for audit committee pre-approval of auditing and permitted non-auditing services;
- imposes on auditors a requirement to report to the audit committee on critical accounting policies and practices and alternative treatment of financial information;
- imposes an auditor attestation requirement in respect of a newly mandated internal control assessment by management;
- establishes a new definition of "independence" for audit committee members of listed companies;
- establishes a new concept of "financial expert" and a requirement that public companies disclose whether or not at least one member of their audit committee is a financial expert (and if not, the reasons why not);
- imposes an ongoing CEO/CFO certification requirement and criminal penalties for knowing or willful violations;
- establishes a requirement for CEO/CFO reimbursement to a company of bonuses, other incentive-based compensation and stock sale profits following a restatement due to material noncompliance attributable to misconduct;
- prohibits virtually all corporate loans to executives and directors;
- accelerates the Section 16 filing requirements in respect of changes in beneficial ownership to two business days;
- directs the SEC to prescribe rules for "real time" disclosure of changes in financial condition or operations;
- establishes new, and enhances existing, criminal penalties; and
- establishes a regulatory oversight framework for auditors.

Provisions Affecting Audit and Non-Audit Services

The following are amendments to Section 10A of the Exchange Act. The SEC has 180 days to adopt final rules to carry out each of these provisions:

1. <u>Auditor Independence</u>

Auditors will be prohibited from providing to a public company, contemporaneously with an audit, any of the following non-audit services:

- bookkeeping or other services related to the accounting records or financial statements of the public company;
- financial information systems design and implementation services;
- appraisal or valuation services, fairness opinions or contribution-in-kind reports;

- actuarial services;
- internal audit outsourcing services;
- management functions or human resources;
- broker or dealer, investment adviser or investment banking services;
- legal services and expert services unrelated to the audit; and
- any other service that the Accounting Oversight Board determines, by regulation, is impermissible.

Auditors may provide any other non-audit services (including tax services), but all audit services and all permitted non-audit services must be pre-approved by the public company's audit committee[1]. The audit committee may delegate the authority to grant such pre-approvals to one or more members of the committee who are independent directors (who will be required to present their decisions to pre-approve services to the full audit committee at its next scheduled meeting). Pre-approvals for services may be made in connection with approval of the audit engagement, rather than on a transaction-specific basis.

A *de minimus* exception is provided for non-audit services that:

- constitute, in the aggregate, less than 5% of the total revenues paid by the public company to its auditor for all services;

- were not recognized by the public company at the time of the engagement to be non-audit services; and

- are promptly brought to the audit committee's attention and approved by the audit committee (or the designated subcommittee) prior to the completion of the audit.

Any approval of non-audit services is to be disclosed in the public company's periodic reports. The Act parenthetically identifies providing comfort letters in connection with securities underwritings as an audit service.

The Accounting Oversight Board is empowered to exempt persons, companies, auditors and transactions from the constraints on non-audit services.

2. Audit Partner Rotation

A lead (or coordinating) audit partner and lead review partner, in effect, must be rotated if he or she has acted as such for five fiscal years. In addition, the General Accounting Office is directed to study the effects of mandatory rotation of audit firms.

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1 For purposes of the Act, a company that does not have a separate audit committee (e.g., a company that is not listed and hence not subject to the independence rules for committee membership) is deemed to be the audit committee.

3. Auditor Communication with Audit Committee

Each auditor must timely report to the audit committee of its audit clients who are public companies:

- all critical accounting policies and practices to be used;
- all alternative treatments of financial information within generally accepted accounting principles that have been discussed with the management of the company, ramifications of the use of such alternative disclosures and treatments, and the treatment preferred by the auditor; and
- other material written communications between the auditor and the management of the public company, such as any management letter or schedule of unadjusted differences.

4. Restrictions on Employment of Auditor Personnel

Auditors will be prohibited from providing audit services to any public company whose chief executive officer ("CEO"), chief financial officer ("CFO"), chief accounting officer or controller or any person serving in an equivalent position was previously employed by the auditor and participated in any capacity in the audit of such public company, within one year of the initiation of the audit.

Additional Provisions Affecting Auditors

1. Auditor Attestation/Report on the Company's Assessment of Internal Controls

As described below, the SEC is required under the Act to prescribe rules requiring each reporting company to include an internal control report in its annual report. In accordance with the standards adopted by the Accounting Oversight Board, auditors will be required to attest to, and report on, the assessment of the effectiveness of the internal control structure made by the management of the company. The attestation is not to be the subject of a separate engagement.

2. Auditor Records Retention

Auditors will be required to retain audit work papers and related documents for a period of five years. Knowing and willful violations of these requirements, as well as other records retention regulations in respect of audit-related documents to be promulgated by the SEC within 180 days, are subject to fines and up to ten years imprisonment, or both.

3. Improper Influence on Audits

The Act directs the SEC to propose rules within 90 days, and promulgate final rules within 270 days, that prohibit any officer or director of a public company or any person acting under their direction from "fraudulently influencing" an auditor for the purpose of rendering the financial statements that are the subject of the audit materially misleading. The SEC is given the exclusive authority to enforce this provision in any civil proceeding.

Provisions Affecting Audit Committees

1. Audit Committees of Listed Companies

Section 10A of the Exchange Act is amended to require the SEC to prescribe rules within 270 days that direct the securities exchanges and associations to prohibit the listing of any public company that does not comply with the following:

- The company shall have granted its audit committee, which shall consist entirely of independent directors, the authority and funding to:

  - directly appoint, compensate and oversee the work of its outside auditors (including resolving disagreements between management and the auditors regarding financial reporting) in preparing or issuing an audit report and related work; and

  - engage independent counsel and other advisors.

- In order to be considered independent for purposes of serving on the audit committee of the listed company, a member may not accept any consulting, advisory, or compensatory fee from the public company, other than in its capacity as a member of the board or any board committee. In addition, an audit committee member may not be a person affiliated with the company or any of its subsidiaries.

The SEC may exempt from these independence requirements particular relationships.

Each audit committee must establish procedures for (i) the receipt, retention and treatment of complaints received by the company regarding accounting, internal accounting controls or auditing matters, and (ii) confidential, anonymous submissions by employees of concerns regarding questionable accounting and auditing matters.

2. Audit Committee Financial Expert

The SEC must propose rules within 90 days, and adopt final rules within 180 days, to require a public company to disclose whether or not its audit committee includes among its members at least one "financial expert," and if not the reasons why not. The SEC is to consider in defining "financial expert" whether a person has, through education and experience as an accountant, CFO, controller or principal accounting officer:

- an understanding of GAAP and financial statements;
- experience in the preparation or auditing of financial statements of generally comparable issuers and the application of such principles in connection with accounting for estimates, accruals and reserves;

- experience with internal accounting controls; and
- an understanding of audit committee functions.

Provisions Affecting Senior Officers

1. CEO and CFO Certifications of Periodic Reports

The SEC is required to prescribe rules within 30 days of enactment of the Act to require each reporting company's CEO and CFO to certify in the periodic reports of the company that:

- each officer has reviewed the report;

- based on such officer's knowledge, the report does not contain any untrue statement of material fact or omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which such statements were made, not misleading; [2]

- based on such officer's knowledge, the financial statements and other financial information included in the report fairly present in all material respects the results of operations and financial condition of the company as of, and for, the periods presented;

- the signing officers are responsible for establishing and maintaining the company's internal controls;

- the signing officers have designed the internal controls to ensure that any material information is made known to such officers by others within the company;

- the signing officers have evaluated the effectiveness of the internal controls within 90 days prior to the publication of the report to which the certification applies;

- the signing officers have presented in such report their conclusions as to the effectiveness of the internal controls based on their evaluation as of that date;

- the signing officers have disclosed to the auditors and the audit committee (i) all significant deficiencies in the design or operation of internal controls which could adversely affect the company's ability to record, process, summarize and report financial data and have identified for the auditors any material weakness in internal controls and (ii) any fraud, whether or not material, that involves management or employees with a significant role in the internal controls; and

- the signing officers have indicated in the report whether or not there were significant changes in internal controls or in other factors that could significantly

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[2] This standard is the same as is required under the June 27th SEC order for the one-time CEO/CFO certifications, and differs from the standard proposed by the SEC for the ongoing certifications.

affect internal controls subsequent to the date of their evaluation, including corrective actions with regard to significant deficiencies and material weaknesses.

As discussed below, a person who knowingly violates this provision is subject to a fine of up to $1 million and imprisonment for up to ten years, and a willful violation is punishable by a fine of up to $5 million and imprisonment for up to twenty years.

2. Codes of Ethics for Senior Financial Officers

The SEC is required to propose rules within 90 days, and adopt final rules within 180 days, under which public companies must disclose in periodic reports whether or not they have adopted a code of ethics for their senior financial officers (and if not, the reasons why not). The SEC is also required within the same time periods to amend its regulations concerning Form 8-K to include as an item for immediate filing, or to disseminate via the Internet or by other electronic means, any change in or waiver of such code of ethics.

The term "code of ethics" means standards as are reasonably necessary 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 SEC periodic reports; and

- compliance with applicable governmental rules and regulations.

3. Reimbursement Related to Accounting Restatements

CEOs and CFOs of public companies will be required to reimburse their companies for bonuses, other incentive-based compensation and profits on stock sales received during the year following the initial publication of a financial report that is subsequently required to be restated due to material noncompliance, as a result of misconduct, with applicable financial reporting requirements.

4. Officer and Director Bars

The SEC is given the authority in administrative cease and desist proceedings to bar an individual who has violated the anti-fraud provisions of the federal securities laws (Exchange Act Section 10(b) and the rules promulgated thereunder; Securities Act Section 17(a) and the rules promulgated thereunder) from acting as an officer or director of a reporting company if the person's conduct demonstrated unfitness to serve as an officer or director of a public company. In addition, the standard that governs imposition of officer and directors bars by a court, in actions brought by the SEC under Section 21(d) of the Exchange Act and Section 20(e) of the Securities Act, is modified from "substantial unfitness" to "unfitness."

5. Ban on Personal Loans to Executives

Section 13 of the Exchange Act is amended to prohibit a public company from, directly or indirectly (including through a subsidiary), extending or maintaining credit, or arranging for the extension of credit, in the form of a personal loan to or for any director or executive officer (or equivalent thereof) of such company. Existing loans, provided they are not amended or extended, are grandfathered. There is an exception for certain loans made in the ordinary course of the public company's consumer credit business that are of the same type and on no more favorable terms than those made available by the company to the general public. Also excepted are margin accounts for employees of public company brokerage firms, except to buy stock of that company, and loans by financial institutions to their employees that are subject to insider lending restrictions under the Federal Reserve Act. Customary relocation loans do not appear to be excepted.

6. Restrictions on Insider Transactions in Securities During Pension Fund Blackout Periods

Directors and executive officers who acquire equity securities of a public company in connection with their service or employment as directors or executive officers are prohibited from purchasing or selling those securities during any non-regularly scheduled "blackout period" of more than three days during which the ability of not fewer than 50% of the participants under the company's retirement plans to trade in those securities is temporarily suspended by the company or plan fiduciary. (The SEC is to promulgate rules excluding regularly scheduled blackout periods.) Any profit realized by a director or executive officer in violation of this provision shall inure to and be recoverable by the company, irrespective of any intention on the part of such director or officer in entering into the transaction. An action to recover the profits may be instituted in any court of competent jurisdiction by the public company or by any shareholder on behalf of the company if the company fails to bring action within 60 days of request.

The Act also amends the Employee Retirement Income Security Act of 1974 ("ERISA") to require plan administrators to notify plan participants and beneficiaries at least 30 days ahead of a blackout period (or as soon as reasonably possible, in cases where the blackout period is prompted by events that were unforeseeable or circumstances beyond the plan administrator's reasonable control) and inform them of the reasons for the blackout period, the expected duration of the blackout and a statement that the participant or beneficiary should evaluate the appropriateness of their current investment decisions in light of their inability to diversify their accounts during the blackout period.

Disclosure Requirements

1. Enhanced Disclosures in Periodic Reports

Section 13 of the Exchange Act is amended to require that reporting companies disclose in their periodic reports any material correcting adjustments that have been identified by their outside auditors in accordance with GAAP or SEC rules and regulations.

The SEC is required to prescribe final rules within 180 days that provide that annual and quarterly reports filed by reporting companies must disclose all material off-balance sheet transactions, arrangements, obligations (including contingent obligations) and other relationships with unconsolidated entities that may have a material current or future effect on the company's financial condition, changes in financial condition, results of operations, liquidity, capital expenditures, capital resources or significant components of revenues or expenses.

The SEC is required to prescribe rules within 180 days that provide that pro forma financial information be presented in a manner that:

- does not contain an untrue statement of material fact or omit to state a material fact necessary in order to make the pro forma information, in light of the circumstances under which such information is presented, not misleading; and

- reconciles the pro forma financial information with the financial condition and results of operations of the company under generally accepted accounting principles.

The rules are to address presentation of pro forma information in any periodic or other report filed with the SEC under the securities laws, or in any public disclosure or press or other release.

2. Expedited Disclosure of Changes in Beneficial Ownership by Insiders

Section 16 of the Exchange Act is amended, effective 30 days after enactment of the Act, to require directors, officers and greater than 10% equity holders of Section 12 registered domestic companies to expedite disclosure of changes in beneficial ownership of their company's equity securities to the end of the second business day after the transaction and to report purchases or sales of "security-based swap agreements" within the same two business days, or in each case such longer period if the SEC finds the two business day-rule not feasible to comply with. Current rules require that Section 16 reports on Form 4 be filed within the first 10 days of the month after the date a change in beneficial ownership takes place.

Effective one year after enactment, disclosures of changes in beneficial ownership must be made to the SEC electronically. Such disclosures are then to be posted on the Internet by the SEC and by the public company on its corporate website, in each case not later than the end of the business day following filing with the SEC. It remains to be seen whether the SEC, in order to avoid duplicative filings, will withdraw its proposed rules requiring domestic Section 12 registered companies to disclose insider transactions in securities on Form 8-K or whether it will modify some of its rules to accelerate reporting of some transactions that currently are reportable at the end of the year on Form 5.

3. Management Assessment of Internal Accounting Controls

The SEC is required under the Act to prescribe rules requiring reporting companies to include an internal control report in their annual reports. The internal control report is to:

- state the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting; and

- contain an assessment, as of the end of the most recent fiscal year, of the effectiveness of the internal control structure and procedures of the company for financial reporting.

Presumably these are the same controls that are covered by the CEO/CFO certifications, though the two provisions are not entirely consistent.

4. Real Time Disclosure

Section 13 of the Exchange Act is amended to require that reporting companies report in plain English on a rapid and current basis any additional information concerning material changes in their financial condition or operations (which may include trend and qualitative information and graphic presentations) as the SEC shall prescribe by rule.

5. Enhanced SEC Review of Periodic Disclosure

The Act requires the SEC to review disclosures made by listed companies on a regular and systematic basis, and in no event shall such a company be reviewed less frequently than once every 3 years. Such a review shall include a review of the company's financial statements. For purposes of scheduling reviews, the SEC will consider, among other factors:

- companies that have issued material restatements of financial results;

- companies that experience significant volatility in their stock price as compared to other listed companies;

- companies with the largest market capitalization;

- emerging companies with disparities in price-to-earning ratios; and

- companies whose operations significantly affect any material sector of the economy.

Penalties and Statute of Limitations

1. Destruction of Documents

The Act provides that a person who knowingly alters or destroys, or makes a false entry in, any record with the intent to obstruct any federal government investigation or bankruptcy case shall be fined, imprisoned for a maximum of 20 years, or both.

2. Securities Fraud

The Act amends the federal criminal fraud statute to provide that a person who knowingly commits, or attempts to commit, securities fraud relating to the securities of a public company will be subject to fines and/or imprisonment for up to 25 years.

3. Conspiracies to Commit Criminal Fraud

The Act amends the federal criminal fraud statute to make conspiracy to commit mail, wire, bank or securities fraud punishable to the same extent as the underlying offense.

4. Criminal Penalties for Mail and Wire Fraud

The maximum term of imprisonment for mail and wire fraud offenses has been increased from 5 to 20 years.

5. Violations of Certification Requirement

A knowing violation by a CEO or CFO of the Act's periodic report certification requirements is punishable by a fine of up to $1 million and imprisonment for up to 10 years. A willful violation is punishable by a fine of up to $5 million and imprisonment for up to 20 years.

6. Review of Federal Sentencing Guidelines

The United States Sentencing Commission is directed to review and, as appropriate, amend the Federal Sentencing Guidelines within 180 days to ensure that the offense levels and sentence enhancements set forth in the Act adequately reflect the serious nature of the offenses proscribed under the Act, are reasonably consistent with other relevant sentencing guidelines and are sufficient to deter and punish those who may be tempted to commit such offenses.

7. Criminal Penalties for ERISA Violations

The Act amends the penalty provisions of ERISA to increase the maximum fine for a violation of the provisions thereof by an individual from $5,000 to $100,000 and the maximum jail term from 1 year to 10 years. Fines for violations committed by companies are increased from $100,000 to $500,000.

8. Statute of Limitations for Securities Fraud

The statute of limitations is extended for private rights of action commenced after enactment of the Act involving claims of fraud, deceit, manipulation or contrivance in contravention of a regulatory requirement under the securities laws, to the earlier of (i) two years after discovery of the facts constituting the violation and (ii) five years after such violation. This replaces current statutes of limitations of one year and three years, respectively.

Other Provisions

1. Analyst Conflicts of Interest

The Act amends the Exchange Act to add a new Section 15D dealing with potential securities analyst conflicts of interest. This new provision directs the SEC (or, upon SEC authorization, a registered national securities exchange or association) to adopt rules, within one year, designed to address conflicts of interest, improve the objectivity of research and provide investors with more useful and reliable information, including rules designed to;

- foster greater public confidence in securities research and protect the objectivity and independence of stock analysts by (i) restricting prepublication clearance of research reports by investment banking personnel, (ii) limiting the supervision and compensatory review of analysts to broker-dealer officials not engaged in investment banking activities and (iii) prohibiting retaliation against analysts who publish unfavorable research reports that may adversely affect the broker-dealer's investment banking relationships;

- define periods during which broker-dealers participating in public offerings of securities may not publish research or recommendations relating to such securities or the issuer of such securities;

- establish effective "Chinese Walls" within broker-dealers to separate securities analysts from review, pressure or oversight of those whose investment banking activities might potentially bias their judgment; and

- require analysts to disclose potential conflicts of interests in public appearances and research reports relating to public companies, including (i) holdings in the securities of the public company, (ii) any compensation received by the broker-dealer or the analyst from the public company (subject to certain exceptions to prevent disclosure of material non-public information), (iii) whether the public company is, or during the one-year period preceding the appearance or report has been, a client of the broker-dealer, and (iv) whether the analyst received compensation based on the broker-dealer's investment banking revenues.

2. Professional Conduct Rules for Attorneys

The SEC is directed to issue rules within 180 days setting forth minimum standards of professional conduct for attorneys practicing before the SEC in representation of public companies, including a requirement that attorneys report evidence of material violations of the securities laws, breaches of fiduciary duty or similar violations by public companies or their agents to the chief legal counsel or CEO of the company. If the counsel or officer does not appropriately respond to the evidence, the new rules are to require the attorney to report the evidence to the public company's audit committee or another board committee comprised solely of independent directors.

3. Whistleblower Protection

Reporting companies and their employees, contractors, subcontractors or other agents may not discriminate in the terms and conditions of employment with respect to employees who provide information or otherwise assist in investigations (by Federal regulatory or law enforcement agencies or members or a committee of Congress) of conduct they reasonably believe constitutes securities law violations or who file, testify or participate in, or otherwise assist in proceedings involving alleged violations of the securities laws or SEC regulations or securities fraud.

4. Dischargeability of Debts in Bankruptcy

The Act provides that debts arising from claims under federal and state securities laws and common law securities fraud are non-dischargeable in bankruptcy.

5. Temporary Freeze Authority for the SEC

The SEC may, during an investigation into securities law violations by a public company or a director, officer, partner, controlling person, agent or employee of a public company, seek a temporary order from a federal district court requiring the company to escrow extraordinary payments (whether compensation or otherwise) to any such person for 45 days (subject to a 45-day extension) or, if such person is charged with a violation of the securities laws, through the expiration of proceedings.

6. Creation of a Public Company Accounting Oversight Board

The Act creates a new oversight committee for the accounting industry named the Public Company Accounting Oversight Board. The board will be an independent, non-profit corporate entity and not an agency or establishment of the U.S. Government. The purpose of the Accounting Oversight Board will be to oversee the audit of public companies subject to the securities laws, and related matters.

The following duties are assigned to the Accounting Oversight Board:

- register public accounting firms that prepare audit reports for public companies;
- establish auditing, quality control, ethics, independence, and other standards relating to the preparation of audit reports for issuers;
- conduct inspections of registered public accounting firms (not less than annually for the large firms);
- conduct investigations and disciplinary proceedings concerning and, where justified, impose appropriate sanctions upon registered public accounting firms and associated persons of such firms;
- perform such other duties or functions as it or the SEC determines are necessary or appropriate to promote high professional standards among, and improve the

quality of audit services offered by, registered public accounting firms and associated persons thereof, or otherwise to carry out the Act, in order to protect investors or to further the public interest;

- enforce compliance with the Act, the rules of the Accounting Oversight Board, professional standards, and the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, by registered public accounting firms and associated persons thereof; and

- set its budget and manage its operations.

The SEC has oversight and enforcement authority over the Board. The Board is expected to be functioning beginning within 270 days. Beginning 180 days thereafter, auditors will have to register with the Board in order to prepare audit reports in respect of a public company.

7. Foreign Public Accounting Firms

The Act states that any foreign public accounting firm that prepares or furnishes an audit report with respect to a public company shall be subject to the Act and to the rules of the Board and the SEC issued under the Act. Registration under the Act shall not by itself provide a basis for subjecting such a foreign public accounting firm to the jurisdiction of Federal or State courts, other than with respect to controversies between such firms and the Board.

Studies and Reports

The Act directs that a number of studies be established to examine various pressing matters concerning the accounting industry, credit rating agencies, violators and violations of securities laws, enforcement actions and investment banks.

1. Study of Mandatory Rotation of Registered Public Accounting Firms

The Comptroller General is directed to study and review the potential effects of requiring the mandatory rotation of registered public accounting firms, with a report to be submitted to Congress within one year.

2. GAO Study and Report Regarding the Consolidation of Public Accounting Firms

The Comptroller General is directed to conduct a study to address various issues arising from the consolidation of public accounting firms and the consequent number of accounting firms that can provide audit services to large national or multi-national firms.

3. Commission Study and Report Regarding Credit Rating Agencies

The Act directs the SEC to study the role and function of credit rating agencies in the operation of the securities market, and in particular the following items:

- the role of credit rating agencies in the evaluation of issuers of securities and the importance of that role to investors and the functioning of issuers of securities;

- any impediments to the accurate appraisal by credit rating agencies of the financial resources and risks of issuers of securities;

- any barriers to entry into the business of acting as a credit rating agency and measures needed to remove those barriers; and

- any conflicts of interest in the operation of credit rating agencies and measures to prevent those conflicts or ameliorate the consequences of such conflicts.

The SEC's report is due in Congress within 180 days.

4. <u>Study and Report on Violators and Violations</u>

The SEC is directed to examine, for the period from January 1, 1998 to December 31, 2001, the number of securities professionals who have engaged in violation of the Federal securities laws.

5. <u>Study on Enforcement Actions</u>

The Acts requires the SEC to review all enforcement actions involving securities laws violations and restatements of financial statements over the past 5-years. The SEC is directed to identify areas of reporting that are most susceptible to fraud, inappropriate manipulation, or inappropriate earnings management and report its findings to Congress within 180 days. The report should provide recommendations of regulatory or legislative steps that may be necessary to address the study's concerns.

6. <u>Study of Investment Banks</u>

The Comptroller General is directed to study the role of investment banks and financial advisers in assisting public companies to manipulate their earnings or obfuscate their true financial condition.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its contents. Any questions concerning the foregoing should be addressed to any of the following members of our Securities Group ("SG"), M&A Group ("MA") or Securities, Futures and Derivatives Litigation Group ("LG"):

Mark S. Bergman - SG	(44 20) 7367 1601	Edwin S. Maynard – SG	(1) 212-373-3024
Richard S. Borisoff –SG	(1) 212-373-3153	Toby S. Myerson - MA	(1) 212-373-3033
Andrew J. Foley – SG	(1) 212-373-3078	Carl L. Reisner - MA	(1) 212 373 3017
Paul D. Ginsberg – SG	(1) 212-373-3131	Richard A. Rosen - LG	(1) 212-373-3305

John C. Kennedy - SG	(1) 212-373-3025	Judith R. Thoyer – MA	(1) 212-373-3002
Daniel J. Kramer - LG	(1) 212-373-3020		

In addition, memoranda on related topics may be accessed under Securities Group publications on our web site (www.paulweiss.com).

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