
The Act applies to any issuer, including any non-US issuer, that has securities registered or is required to file reports under the Securities Exchange Act of 1934 (the “Exchange Act”). It also applies to an issuer that has filed a registration statement under the Securities Act of 1933 that is not yet effective. The Act does not apply to issuers who merely submit information under Rule 12g3-2(b) of the Exchange Act.

The Act contains no explicit exemption for foreign private issuers. It is unclear how certain provisions of the Act will apply to foreign private issuers. Although certain provisions of the Act are effective immediately, others require the adoption of rules by the SEC. The SEC has general authority to provide exemptions from certain provisions of the Act. However, it is not yet known whether the SEC will grant any exemptions for foreign private issuers, either with respect to those provisions of the Act that are effective immediately or in connection with the adoption of implementing rules.

Selected provisions of the Act of particular importance to foreign private issuers are highlighted below. We encourage you to read our memorandum entitled “Sarbanes-Oxley Act of 2002” distributed to you separately for a more detailed discussion of these as well as other provisions of the Act as they generally pertain to all reporting issuers, including foreign private issuers.

1 For a text of the Act, H.R. 3763, 107th Cong. (2002), as approved by Congress and submitted to the President, see http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=107_cong_bills&docid=f: h3763enr.txt.pdf.
similar functions, to provide certifications in each annual or quarterly report filed or submitted under Section 13(a) or 15(d) of the Exchange Act regarding, among other things, material disclosures, fair presentation of financial statements and other financial information and the adequacy of internal financial controls.

On August 2, 2002, the SEC published a release setting forth its intention with respect to implementing Section 302. Notably, for foreign private issuers, the SEC plans to require such certifications with respect to Form 20-F and Form 40-F. The SEC is going to incorporate the 302 provisions into its already published certification proposal2.

**Personal Loans to Officers and Directors**

Effective immediately, the Act prohibits issuers from, directly or indirectly, including through any subsidiary, extending or maintaining credit, arranging for the extension of credit, or renewing an extension of credit, in the form of a personal loan to or for any director or executive officer. Loans in existence as of July 30, 2002 are not prohibited, provided that on or after that date there is no material modification of any term of the loan and it is not extended or renewed. There are some very limited exceptions.

**Audit Committee/ Auditor Independence**

The SEC is directed to adopt a rule no later than 270 days after enactment of the Act directing the national securities exchanges and national securities associations to prohibit the listing of any security of any issuer unless such issuer’s audit committee meets certain requirements as to composition and operation.

**Audit Committee Requirement**

Interestingly, the Act does not seem to mandate that issuers have an audit committee but states that, in the absence of such a committee, the audit committee would comprise the issuer’s entire board of directors. However, each member of the audit committee must be a member of the board of directors of the issuer and otherwise be independent. In order to be considered independent under the Act, a member of an audit committee may not, other than in his or her capacity as a member of the audit committee, the board of directors, or any other board committee, accept any consulting, advisory or other compensatory fee from the issuer or be an affiliated person of the issuer or any of its subsidiaries.

Since, under this definition, officers of the issuer are not permitted to serve on the audit committee, the practical effect of this provision would seem to be to require foreign private issuers whose boards include even a single officer – which presumably amounts to substantially all such issuers – to establish a separate audit committee comprised solely of independent directors.

Such a requirement would constitute a significant departure from existing SEC rules, which do not impose an obligation on public companies to have audit committees. It would also differ from existing rules of both the NYSE and Nasdaq, under which exemptions have been granted to foreign private issuers whose home country law and practice either do not require audit committees or differ on the composition of such committees.

Until the SEC adopts implementing rules, it will be unclear whether the SEC will require US-listed foreign private issuers to establish audit committees comprised solely of independent directors or will instead provide relief from this requirement by way of an exemption or by permitting the exchanges to retain the ability to exempt foreign issuers based on their home country law and practice.

On August 1, 2002, the New York Stock Exchange (“NYSE”) announced its final corporate governance rules, which include a number of provisions with respect to audit committees. Notably, listed foreign private issuers must disclose any significant ways in which their corporate governance practice differs from NYSE rules rather than having to comply with the specific NYSE requirements. Similarly, Nasdaq has proposed rules, pending approval by the NASD Board, pursuant to which foreign private issuers must disclose all exemptions to US corporate governance listing standards due to contrary home country practice.

**Role of Audit Committee**

The Act amends Section 10A of the Exchange Act to require registered public accounting firms to timely report to audit committees with respect to certain matters including critical accounting policies and practices, alternative treatments of financial information and material written communications between the audit firm and management.

Audit committees are required to pre-approve all audit services and non-audit services, which are not prohibited by the Act, including tax services, to be performed by the independent auditors and to disclose any approvals of such non-audit services in the company’s periodic reports. Certain non-audit services are prohibited.

Under the rules to be adopted by the national securities exchanges and national securities

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associations as directed by the SEC, audit committees must:

- be directly responsible for the appointment, compensation, and oversight of registered public accounting firms (including resolution of disagreements between management and the auditor regarding financial reporting for the purpose of issuing an audit report), and such firms must report directly to the audit committee;
- establish procedures with respect to complaints regarding accounting, internal accounting controls, or auditing matters, including those submitted anonymously by employees; and
- have the authority to engage, and determine the fees of, independent counsel and other advisors as they determine necessary.

Enhanced Disclosure Requirements and SEC Review

“Real Time” Disclosure

The Act requires disclosure on “a rapid and current basis” of additional information, as the SEC determines appropriate and requires, regarding material changes in financial condition or operations, which may include “trend” and “qualitative information” and “graphic presentations”. The Act does not set a deadline for the SEC rulemaking.

Until the SEC adopts rules implementing this provision, it is unclear the extent to which this provision will result in changes to current disclosure rules and practice. In particular, this provision could result in a very significant change for foreign private issuers if the SEC interprets this mandate to require specific interim or other reports with prescribed provisions or at prescribed times rather than allowing such issuers to rely on their home country law and practice to satisfy SEC ongoing reporting.

Financial Disclosure

Effective immediately, the Act requires disclosure in periodic reports of all material correcting adjustments identified by the issuer’s independent auditor in accordance with generally accepted accounting principles and SEC rules.

In addition, the Act requires the SEC to propose no later than 90 days after enactment and adopt no later than 180 days after enactment rules requiring an issuer to disclose whether its audit committee has at least one member who is a financial expert.

The SEC is directed to adopt no later than 180 days after enactment of the Act rules implementing provisions regarding disclosure of off-balance sheet transactions and the presentation of pro forma information.

Additional Disclosures

The Act directs the SEC to adopt rules requiring disclosure regarding the issuer’s internal financial controls. Each annual report must contain an internal control report and an assessment of the effectiveness of the internal control structure and procedures for financial reporting, such assessment attested to and reported on by the audit firm preparing the audit report. The Act is silent as to the timing of the adoption of these rules.

The Act requires the SEC to propose rules no later than 90 days after enactment and adopt no later than 180 days after enactment rules requiring disclosure on whether or not (and if not, why not) the issuer has a code of ethics for senior financial officers, applicable to its principal financial officer and comptroller or principal accounting officer.

Regular SEC Reviews

The Act requires the SEC to review each issuer’s disclosure, including financial statements, on a regular and systematic basis and at least once every three years.

Officers and Directors: Penalties for Misconduct

Disgorgement of Bonuses and Profits in the Event of a Restatement

If an issuer is required to prepare an accounting restatement due to the material noncompliance of the issuer, as a result of misconduct, with any financial reporting requirements, effective immediately, the Act requires the CEO and CFO to disgorge to the issuer:

- any bonus or other equity or incentive-based compensation paid by the issuer during the 12-month period following the first public issuance or filing of the noncompliant financial document; and
- any profits realized from the sale of the issuer’s securities during the same 12-month period.

The Act grants the SEC the authority to exempt individuals from these disgorgement provisions, as it deems necessary and appropriate. A key issue will be the meaning of “as a result of the misconduct of the issuer”.

Officer and Director Bars

The Act permits the SEC to issue an order in any cease and desist proceeding prohibiting any person found guilty of violating certain provisions of the...
Federal securities laws from acting as an officer or director of a public company if that person’s conduct demonstrates unfitness to serve. The Act changes the standard for court ordered officer and director bars from “substantial unfitness” to “unfitness”.

**Professional Conduct Rules: Attorney Reporting of Violations**

The SEC is directed to issue rules no later than 180 days after enactment of the Act establishing minimum standards of professional conduct for attorneys appearing and practicing before the SEC in connection with the representation of issuers. It does not appear that these rules are to make any distinction between in-house and outside counsel.

The standards are to include a rule requiring attorneys to report evidence of material violations of securities laws or breaches of fiduciary duty or similar violations by their issuer clients to the chief executive officer or chief legal counsel and, if that officer does not appropriately respond, to the audit committee (or other committee composed entirely of outside directors) or board of directors.

**Public Company Accounting Oversight Board**

The Act requires the establishment of a five-member Public Company Accounting Oversight Board (the “Board”) to oversee the audit of public companies.

The Act directs the Board to establish by rule fair procedures for the investigation and discipline of audit firms and associated persons. Under these rules, the Board may, among other things, request the testimony of, and the production of any document in the possession of, clients of an audit firm under investigation that it considers relevant or material to such investigation. The Act is silent as to the timing of the adoption of these rules.

The Act also applies to foreign audit firms that audit Exchange Act reporting issuers or whose audit reports are relied upon by auditors issuing audit reports to Exchange Act reporting issuers.

The Board and the Financial Accounting Standards Boards will be funded through annual fees assessed against public companies based on each such company’s market capitalization.

This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired. For more information on the topics covered in this issue, please contact:

<table>
<thead>
<tr>
<th>Name</th>
<th>Location</th>
<th>Contact Information</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stephan Hutter</td>
<td>Frankfurt Office</td>
<td>(+49 69) 9711-1000</td>
</tr>
<tr>
<td>Thomas J. Friedmann</td>
<td></td>
<td></td>
</tr>
<tr>
<td>James M. Bartos</td>
<td>London Office</td>
<td>(+44 20) 7655-5000</td>
</tr>
<tr>
<td>Pamela Gibson</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bonnie Greaves</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lee Edwards</td>
<td>Beijing Office</td>
<td>(+86 10) 6505-3399</td>
</tr>
<tr>
<td>Robert Ellison</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Manila Bosco</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Michael Price</td>
<td>Singapore Office</td>
<td>(+65) 6230-3800</td>
</tr>
<tr>
<td>Linda C. Quinn</td>
<td>New York Office</td>
<td>(+1 212) 848-4000</td>
</tr>
<tr>
<td>Richard Price</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Masahisa Ikeda</td>
<td>Tokyo Office</td>
<td>(+81 3) 5251-1601</td>
</tr>
<tr>
<td>John Wilson</td>
<td>San Francisco Office</td>
<td>(+1 415) 616-1100</td>
</tr>
<tr>
<td>[Other contacts]</td>
<td></td>
<td></td>
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