ACC Association of Corporate Counsel

Sarbanes Oxley Primer For The Small Law Department

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Sarbanes Oxley Primer For The Small Law Department

September 2005

Provided by the Association of Corporate Counsel
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This primer provides a broad overview of several provisions of Sarbanes Oxley. It does not cover all of SOX's provisions or related rules. It is intended to offer non-securities law practitioners practicing as in-house counsel, a brief introduction into SOX topics, and perhaps to provide a quick, summary level "brush-up" for securities practitioners. To aid readers in their understanding of the covered topics, this primer includes practice tips and several forms and reference materials in the Samples and Forms section at the end. As each company and securities matter presents unique facts and considerations, legal and otherwise, readers are cautioned not to use these tips and forms without carefully reviewing and analyzing the specific company and/or individual at issue and their needs and circumstances.

We hope that you find this material useful. Thank you for consulting with the Association of Corporate Counsel.

The information contained in this InfoPAK[SM] was compiled by Holland and Knight LLP at the direction of the ACC. ACC wishes to acknowledge the following members of Holland and Knight LLP for their contribution to the development of this InfoPAK[SM]:

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I. Coverage and Use of this Primer

This document is a primer providing a broad overview of several provisions of SOX. It does not cover all of SOX's provisions or related rules. It is intended to offer non-securities law practitioners practicing as in-house counsel, a brief introduction into SOX topics, and perhaps to provide a quick, summary level "brush-up" for securities practitioners.

As a primer, the primer covers its subject matter in summary form and does not delve into many of the detailed exceptions included in SOX and subsequent rules, or into the more intricate nuances of the provisions discussed. Readers are therefore cautioned that the information and materials provided in this primer present general information and should not be used or relied on as legal advice when analyzing and resolving a specific legal issue.

To aid readers in their understanding of the covered topics, this primer includes practice tips and several forms and reference materials in the Samples and Forms section at the end. As each company and securities matter presents unique facts and considerations, legal and otherwise, readers are cautioned not to use these tips and forms without carefully reviewing and analyzing the specific company and/or individual at issue and their needs and circumstances.

Although many of the provisions of SOX were implemented by SEC rulemaking at various times since SOX's passage in July 2002, almost all of the effective dates relating to the topics covered by this primer have occurred as of the date of this writing. In addition, although the Act and related rules apply in many circumstances to non-U.S. companies, this primer does not provide a discussion of the specific rules covering foreign companies.

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II. Board of Directors

A. Overview

By December 31, 2005, a majority of the board members of all listed companies (including those with a classified board, foreign private issuers and small business issuers) must be "independent" directors. No director qualifies as independent unless the Board of Directors affirmatively determines that the director does not have a material relationship with the listed company, either directly or indirectly (as a partner, shareholder or officer of an organization that has a relationship with the company), that would interfere with the exercise of his/her independent judgment in carrying out the responsibilities of a director. A listed company must identify which of its directors are independent and disclose the basis for that determination in either its annual meeting proxy statement or annual report on a Form 10-K. As stated in the commentary of the NYSE listing rules, "[r]equiring a majority of independent directors will increase the quality of board oversight and lessen the possibility of damaging conflicts of interest."

B. Director Independence

1. Definition of "Independence"

NASDAQ and the NYSE have very similar requirements for director independence, except that some of the NASDAQ numerical thresholds are lower. For a NASDAQ-listed company, a director is not deemed independent if any of the four circumstances exist:

(i) the director is currently, or was at any time during the past three years, employed by the company, its parent or subsidiaries, or if any of the director's family members is, or was, an executive officer of the company, its parent or subsidiaries, at any time during the past three years;

(ii) the director accepts, or has a family member who accepts, from the company, its parent or subsidiaries, any payment in excess of $60,000 during the current or any of the past three fiscal years, other than (a) compensation for board service, (b) payments arising from investments in the company's securities; (c) compensation paid to a family member who is a non-executive employee of the company, its parent or subsidiary; (d) compensation received for former service as an interim chairman or CEO; (e) benefits under a tax-qualified retirement plan, and (f) loans not prohibited under SOX;

(iii) the director is, or has a family member who is, a partner in, or a controlling shareholder or an executive officer of, any organization to which the company made, or from which the company received, payments (other than payments arising solely from investments in the company's securities or payments under non-discretionary charitable contribution matching programs) that exceed the greater of $200,000 or 5% of the recipient's consolidated gross revenues during the current or any of the past three fiscal years; or

(iv) the director is, or has a family member who is, a current partner of the company's outside auditor, or was a partner or employee of the company's outside auditor who worked on the company's audit at any time during the past three years.

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Practice Tip:

If you have a board of directors comprised of seven individuals, four of whom are independent, it is very important that the four independent directors remain independent throughout the term of their directorships. As soon as one of the four independent directors resigns for any reason, the company no longer complies with the listing rules. Upon notification of the non-compliance, the stock exchange listing the company's securities will issue a warning letter about a possible delisting if the company fails to cure the deficiency. Within four business days of receiving a warning letter, the company must file a Form 8-K with the SEC disclosing its failure to satisfy a continued listing rule. One way to avoid the stock exchange's warning letter (and the Form 8-K filing) is to have one of the non-independent directors voluntarily resign while the company conducts a search for a new independent director. The resigning non-independent director may be re-elected to the Board as soon as a new independent board member candidate is identified and elected to the Board.

2. "Controlled Company" Exception

If more than 50% of the voting power of a listed company is held by an individual, a group or another company, the majority independent director rule does not apply.[1] Controlled companies using this exception must disclose in their annual meeting proxy statement or in their next annual report on a Form 10-K their controlled company status and the basis of that determination.

3. Executive Sessions

To empower non-management directors to serve as a more effective check on management, the NYSE requires that non-management directors of each listed company must meet at regularly scheduled executive sessions without management. "Non-management" directors are those who are not executive officers. The NASDAQ requires that only independent directors can be present at these executive sessions, and that they should occur at least twice a year in conjunction with regularly scheduled board meetings. AMEX requires that independent directors meet at least once a year in executive session without the non-independent directors and management. Note that no exception exists for controlled companies.

Having regularly scheduled meetings among non-management directors in the absence of management fosters better communication. Making sure that these meetings are regularly scheduled in advance also helps prevent any negative inference from attaching to the calling of executive sessions.

4. Sample Questions Included in the D&O Questionnaires

Companies should conduct governance reviews when necessary, but in no event less than once a year. To determine a director's independence and his/her continued independence during his/her term on the Board, companies need to know at all times any of the director's relationships or transactions that could be deemed to affect his/her independence. Requiring director candidates (and annually after their appointment) to respond to a D&O Questionnaire is an easy and common method to give the Board the information necessary to determine whether or not a director is independent. An excerpt of a D&O Questionnaire containing questions pertinent to an individual's independence is attached Sample II-1.

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[1] Section 303A of the NYSE Corporate Governance Rules, Rule 4350(c)(5) of the NASDAQ listing rules and Section 801(a) of AMEX Company Guide.

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III. Audit Committee

A. Overview

Each member of a listed company's audit committee must be independent. In other words, the director may not accept any consulting, advisory, or other compensatory fees (other than directors' fees) from the listed company or be an affiliated person of the listed company. Each audit committee must establish procedures for the receipt, retention, and treatment of complaints received by the company regarding accounting, internal accounting controls or auditing matters, and the confidential, anonymous submission by employees of their concerns regarding questionable accounting or auditing matters. The Exchange Act gives the audit committee the express authority to engage its own independent counsel and other advisors, as it deems necessary to carry out its duties, and the issuer must provide the appropriate funding for paying the independent counsel and separate advisors.[2]

B. Most Common Exemptions from the Independence Requirements

Rule 10A-3 of the Exchange Act provides certain limited exemptions from the independence requirements. Three of the most common scenarios are dual holding companies, IPOs, and ordinary director fee situations:

- Dual holding companies. In the case where a listed company is one of two dual holding companies, those companies may designate one audit committee for both companies so long as each member of the audit committee is a member of the Board of Directors of at least one such dual holding companies.[3]
- IPOs. For the first 90 days after the effective date of its initial public offering registration statement, the issuer is required to only have one member of its Audit Committee independent; and for the first twelve months after the effective date of its IPO registration statement, the issuer is required to have only a majority of the members of its Audit Committee independent.[4]
- Ordinary-course fees. An audit committee member that sits on the Board of Directors of a listed company and an affiliate of the listed company can still be independent for as long as the director has not received from each of the two Boards any compensation other than ordinary-course director's fees.[5]

In addition, under both NASDAQ and AMEX rules, one director who is not independent and is not a current officer of employee or an immediate family member of such person, may be appointed to the audit committee, if the Board, under exceptional and limited circumstances, determines that membership on the committee by the individual is required by the best interests of the company and its shareholders, and the board discloses, in the next annual meeting proxy statement subsequent to such determination, the nature of the relationship and the reasons for that determination. However, note that a director appointed to the audit committee pursuant to this exception may not serve for more than

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[2] Section 10A(m)(5) and (6).
[3] Rule 10A-3(b)(1)(i).
[4] Rule 10A-3(b)(1)(iv)(A).
[5] Rule 10A-3(b)(1)(iv)(B).

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two years.[6]

Practice Tip:

> *What if you are the GC of a listed company and one of your independent audit committee member ceases to be independent due to a recent event outside of that member's reasonable control? First, you need to inform the stock exchange on which your securities are listed. Under Rule 10A-3(a)(3) of the Exchange Act and applicable exchange rules[7], the non-independent audit committee member in this instance can remain on the audit committee until the earlier of the listed company's next annual shareholders' meeting or one year from the occurrence of the event that caused the failure to comply with the requirement.*

C. The "Financial Literacy" Requirement

Each NYSE or NASDAQ listed company must have a minimum of three persons on its audit committee. Each member must be "financially literate." In other words, each member must be able to read and understand the fundamental financial statements, including a company's balance sheet, income statement and cash flow statement. In addition, at least one audit committee member must be a "financial expert."

D. Requirements of a "Financial Expert"

A listed issuer must disclose in its annual report on a Form 10-K (or proxy statement in some cases) whether or not it has at least one financial expert serving on its audit committee. If the company has such a financial expert on the audit committee, it must identify the financial expert and disclose whether or not the expert is an independent director. If the company does not have a financial expert on its audit committee, it must provide its reasons for not having one.[8]

1. Attributes Required of an Audit Committee "Financial Expert"

To be an audit committee financial expert, one must have the following five attributes:

- GAAP knowledge. An understanding of generally accepted accounting principles and financial statements;.
- GAAP application. The ability to assess the general application of such principles in connection with the accounting for estimates, accruals and reserves;
- Accounting experience. 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 issuer's financial statements, or experience actively supervising one or more persons engaged in such activities;
- Internal control. An understanding of internal control over financial reporting; and
- Audit functions. An understanding of the audit committee functions.

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[6] Rule 4350(d)(2)(B) of the NASDAQ listing rules and Section 803(a) of the AMEX Company Guide.

[7] Rule 4350(d)(4)(C) of the NASDAQ listing rules and Section 803(a) of the AMEX Company Guide.

[8] Item 401(h)(1) of Regulation S-K.

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2. How Attributes can be Acquired

An independent director may acquire the necessary attributes to be a "financial expert" through one or more of the following three avenues:

- Employment. Past employment experience in finance or accounting, through preparing, auditing, analyzing or evaluating public company financial statements;
- Professional certification. Requisite professional certification in accounting, e.g. as a Certified Public Accountant; or
- Executive experience. Being a chief executive officer, chief financial officer or other senior officer with financial oversight responsibilities at a publicly held company.

E. Additional Disclosure in the case of Simultaneous Service on Multiple Audit Committees

If an audit committee member of a NYSE-listed company simultaneously serves on the audit committee of more than three public companies, and the listed company does not limit the number of audit committees on which one may serve, each NYSE-listed company board must determine and disclose that such simultaneous service does not impair the ability of such member to effectively serve on the listed company's audit committee. As a result of this disclosure requirement, most companies discourage audit committee members from contemporaneously serving on two or more audit committees of public companies.

F. Audit Committee Responsibilities

Under Section 301 of SOX, an audit committee is "directly responsible for the appointment, compensation and oversight of the work of any registered public accounting firm employed by that issuer (including resolution of disagreements between management and the auditor regarding financial reporting) for the purpose of preparing or issuing an audit report or related work, and each such registered public accounting firm shall report directly to the audit committee." In addition, it is responsible for establishing procedures for the receipt, retention, and treatment of complaints received by the company regarding accounting, internal accounting controls or auditing matters, and the confidential, anonymous submission by employees of their concerns regarding questionable accounting or auditing matters.

Under the NYSE rules, the audit committee also has eight additional responsibilities.

- Annual reports. Annually obtain and review a report by the independent auditor;
- Management discussions. Discuss the company's annual audited financial statements and quarterly financial statements with management and the independent auditor, including the company's MD&A;
- Earning press releases. Discuss the company's earnings press releases as well as financial information and earnings guidance provided to analysts and rating agencies;
- Risk Assessment. Discuss policies with respect to risk assessment and risk management;

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- Periodic meetings. Meet separately and periodically with management, with internal auditors (or other personnel responsible for the internal audit function), and with independent auditors;
- Audit review. Review with independent auditors any audit problems or difficulties in management's response;
- Hiring policies. Set clear hiring policies for employees or former employees of the independent auditors; and
- Regular reporting. Report regularly to the Board.

Practice Tip:

Listed companies are expected to review and oversee related party transactions on an on-going basis. Although not expressly set forth in SOX or any of the stock exchanges' rules as one of the audit committee's many responsibilities, you should note that a company's audit committee, comprised solely of independent directors, is the proper forum for such review and oversight.

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IV. Compensation Committee

A. Overview

The NYSE requires that all listed companies have a compensation committee with a written charter. The charter must address the committee's purpose and responsibilities and provide for an annual performance evaluation of the committee. Neither NASDAQ nor AMEX has a similar compensation committee requirement. However, both exchanges require that compensation of their listed companies' CEOs be determined (or recommended to the Board) by either a majority of independent directors or a compensation committee comprised solely of independent directors. The CEO may not be present during the Board's voting or deliberations of the CEO's compensation.

B. Non-independent Director Hardship Exemption

Under both NASDAQ and AMEX rules, if the compensation committee has at least three members, the Board may appoint one director who is not independent and is not a current officer or employee (or an immediate family member of such person). Such an appointment can be made only if the Board, under exceptional and limited circumstances, determines that the best interests of the company and its shareholders require the individual's membership and the Board discloses, in the next annual meeting proxy statement subsequent to such determination, the nature of the relationship and the reasons for that determination. A compensation committee director appointed under this exception may not serve for more than two years.[9]

C. Compensation Committee Responsibilities

The NYSE requires that all its listed companies post on their company websites their compensation committee charters. These charters must address the following six elements:

- Committee purpose. Committee's purpose, including discharging the Board's responsibilities relating to compensation of executive officers, and preparing a committee report to be included in the company's annual meeting proxy statement;
- Goals. Approving the goals relevant to the CEO compensation;
- CEO evaluation. Evaluating the CEO performance in light of the goals;
- CEO compensation. Making recommendations to the Board with respect to incentive compensation plans and equity-based plans;
- Annual evaluation. Annual performance evaluation of the committee; and
- CEO's compensation. Establishing the CEO's compensation.

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[9] Rule 4350(c)(3)(C) of the NASDAQ listing rules and Section 805(b) of the AMEX Company Guide.

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V. Nominating/Corporate Governance Committee

A. Overview

The NYSE requires that all its listed companies have a nominating/corporate governance committee with a written charter. The charter must address the committee's purpose and responsibilities and provide for an annual performance evaluation of the committee. The NASDAQ and AMEX require that nomination of directors be determined by either a majority of the independent directors or a nominating committee comprised solely of independent directors. However, this rule does not apply if a third party has the legal right to nominate a director (e.g. by virtue of a voting agreement among significant shareholders or lenders). In addition, both exchanges require their listed companies to adopt a formal written charter or board resolution regarding the nominations process and related matters.

B. Non-independent Director Hardship Exemption

Under both NASDAQ and AMEX rules, if the nominating committee is comprised of at least three members, one director who is not independent and is not a current officer of employee or an immediate family member of such person, may be appointed to the compensation committee. To make such an appointment, the Board, under exceptional and limited circumstances, must determine that the individual's membership on the committee is required by the best interests of the company and its shareholders, and the Board discloses, in the next annual meeting proxy statement subsequent to such determination, the nature of the relationship and the reasons for that determination. A nominating committee director appointed under this exception may not serve for more than two years.[10]

C. Nominating/Corporate Governance Committee Responsibilities

The nominating/corporate governance committee is responsible for identifying, recruiting and nominating qualified director candidates to the Board. Although not required by law, the nominating committee/corporate governance committee should also have the responsibility for establishing (i) director qualification standards, (ii) director compensation, (iii) directors' orientation and continuing education on the Board's fiduciary duties and other corporate governance issues, (iv) management succession plan, and (v) corporate governance guidelines. Due to the important vast knowledge base required of members of this committee, the nominating/corporate governance committee should be given a specific budget each year on directors' education and outside advisory services.

D. Required Proxy Statement Disclosure

The SEC proxy rules require an issuer to disclose in its annual meeting proxy statement whether or not it has a standing nominating committee. Set forth below are the general disclosure requirements applicable to the director nomination process:

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[10] Rule 4350(c)(4)(C) of the NASDAQ listing rules and Section 804(b) of the AMEX Company Guide.

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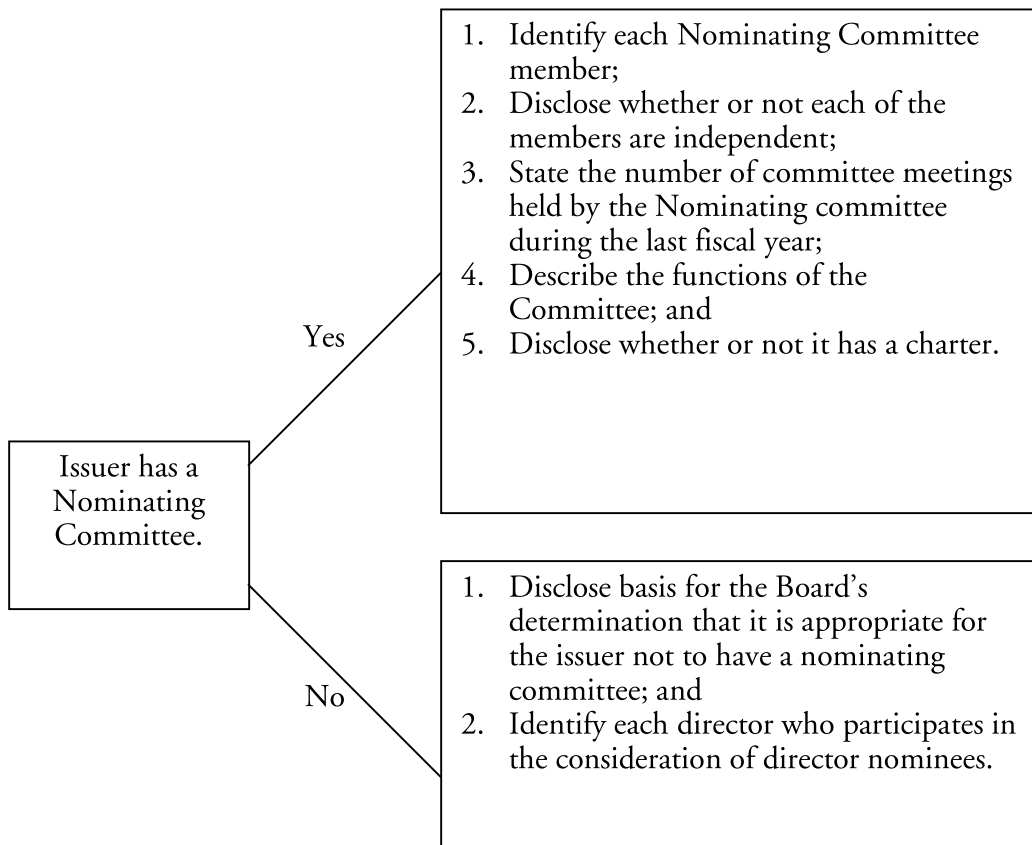

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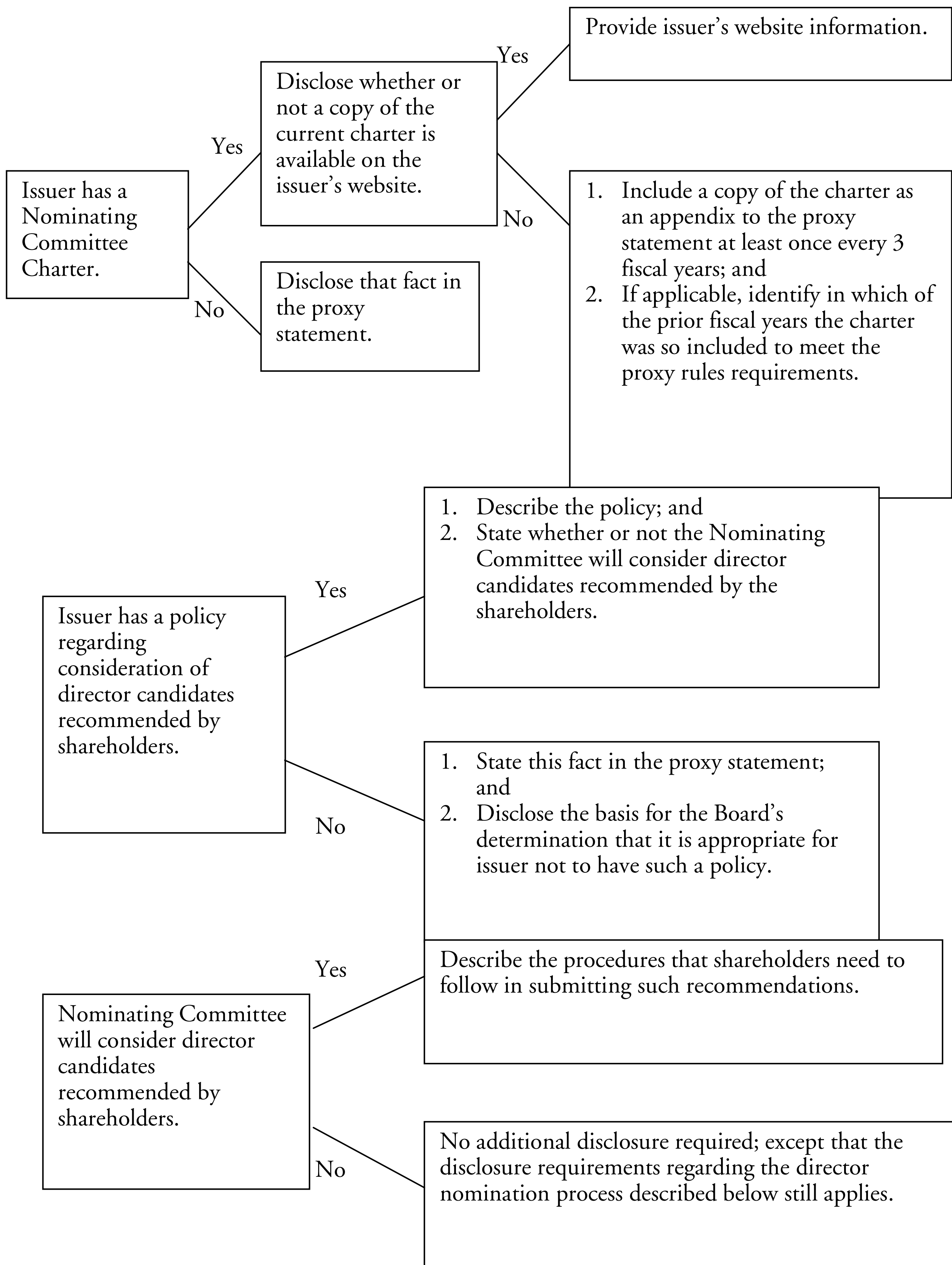

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Regardless of whether or not an issuer has a nominating committee, a group of directors or the entire board fulfilling the role of a nominating committee, the issuer is required to disclose in the proxy statement its director nomination process, including the following:

1. disclose any specific, minimum qualifications that the committee or board believes must be met by its recommended director nominees;

2. describe any specific qualities or skills that the committee or board believes are necessary for one or more of the issuer's directors to possess;

3. describe the process for the committee or board to identify and evaluate director nominees, including those recommended by shareholders;

4. disclose if there are any differences in the manner in which the nominating committee evaluates director nominees based on whether or not the nominee is recommended by a shareholder;

5. with respect to each nominee named on the proxy card (except for the director nominees who are executive officers or are standing for re-election), state which one or more of the following categories of persons recommended that nominee: shareholder, non-management director, chief executive officer, other executive officer, third party search firm, or other, specified sources;

6. if the issuer pays a fee to any third party or parties to identify or evaluate or assist in identifying or evaluating potential nominees, disclose the function performed by each such third party;

7. if the nominating committee received within 120 days from the date of the issuer's proxy statement was released to shareholders in connection with its annual meeting the previous year, a nomination from a shareholder (or a group of shareholders) that has been the beneficial owner of more than 5% of the issuer's voting common stock for at least 1 year, identify (with the written consent of the respective parties) the candidate, the shareholder or shareholder group that recommended the candidate, and disclose whether or not the nominating committee chose to nominate the candidate.

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VI. Accelerated/Enhanced Disclosure Requirements

A. General Overview

One of the major changes made by SOX to existing practices prior to SOX is the change to the timing and content of an issuer's regular periodic disclosures. All reporting companies must file current reports (Form 8-K), Quarterly Reports (Form 10-Q), and Annual Reports (Form 10-K). These reports are some of the building blocks of the integrated disclosure scheme established pursuant to the Securities Exchange Act of 1934. In response to a perceived weakness in the existing regulatory scheme, SOX provides for accelerated and enhanced disclosures in an effort to provide the public with information on a more timely and comprehensive basis. Some of the new filing deadlines were phased in over a three-year period beginning in 2002.

B. Applicability of New Rules

In general, the new accelerated filing requirements are applicable to "accelerated filers", as defined in Rule 12b-2 of the Exchange Act. The term "accelerated filer" means any issuer, after it first meets the following four conditions as of the end of its fiscal year:

1. The aggregate market value of the voting and non-voting common equity held by non-affiliates of the issuer is $ 75 million or more;

2. The issuer has been subject to the requirements of Section 13(a) or 15(d) of the Act for a period of at least twelve calendar months;

3. The issuer has filed at least one annual report pursuant to Section 13(a) or 15(d) of the Act; and

4. The issuer is not eligible to use Forms 10-KSB and 10-QSB for its annual and quarterly reports.

The determination for whether a non-accelerated filer becomes an accelerated filer as of the end of the issuer's fiscal year governs the annual report to be filed for that fiscal year, the quarterly and annual reports to be filed for the subsequent fiscal year and all annual and quarterly reports to be filed thereafter while the issuer remains an accelerated filer. Once an issuer becomes an accelerated filer, it will remain an accelerated filer unless the issuer becomes eligible to use Forms 10-KSB and 10-QSB for its annual and quarterly reports. In that case, the issuer will not become an accelerated filer again unless it subsequently meets the conditions set forth above.

Under the pre-SOX reporting framework, 10-Ks were due 90 calendar days after an issuer's fiscal year end and 10-Qs were due 45 calendar days after an issuer's fiscal year end. For accelerated filers with a fiscal year ending after December 14, 2004, Form 10-K must be filed 60 calendar days after fiscal quarter end, and Form 10-Q must be filed 35 calendar days after fiscal quarter end. The SEC did not accelerate the filing deadlines for proxy statements or information statements for which information will be incorporated by reference, and the filing deadline for these statements will continue to be 120 days after fiscal year end.

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Recognizing the heavy burden faced by foreign issuers and small public companies, on March 2, 2005, the SEC extended the date for compliance to "the first fiscal year ending on or after July 15, 2006" for foreign issuers and non-accelerated filers. Final Rule Release no. 33-8545. The SEC cited in particular challenges found by foreign issuers in connection with the transition to the European Union Laws (including new requirements included under the International Financial Reporting Standards). In addition, the SEC wanted to give non-accelerated filers the opportunity to review the report of the Committee of Sponsoring Organizations, which is expected to provide some additional guidance for small public companies in establishing an internal control framework. However, the SEC made it very clear that issuers that benefit from this extension should not use it as an opportunity to curb their efforts to establish an internal control framework.

C. 10-Ks and 10-Qs

The major substantive change to the 10-K filing requirements is the obligation of issuers to include in their annual reports a report of management on the issuer's internal controls over financial reporting pursuant to Section 404 (see Section VII). The management report must be filed for all accelerated filers commencing with fiscal years ending on or after June 15, 2004. If an issuer fails to comply with the timely filing requirements of the 10-Ks, 10-Qs or to include the management report, the issuer will be barred from using short form registration statements and may be subject to enforcement action by the SEC.

All issuers who file Form 10-K and Form 10-Q are subject to the following additional disclosure items:

- The issuer must indicate on the cover of each 10-K and 10-Q whether or not it is an accelerated filer.
- The issuer must indicate on the cover of each 10-K the aggregate market value of its voting and non-voting common equity held by non-affiliates as of the last business day of the registrant's most recently completed fiscal quarter. (Previously this disclosure was as of a specified date within 60 days prior to the date of filing.)

1. Changes to Filings Made Within 90 days of Fiscal-Year End

Under current rules, if a filing (other than Form 10-K or Form 10) is made within 45 days after the company's fiscal-year end and audited financial statements for the most recent fiscal year are not available, the latest balance sheet (and income statement) may be as of the end of the third quarter of the most recently completed fiscal year. In addition, under current rules, if a filing (other than Form 10-K or Form 10) is made after 45 days and within 90 days of the end of the company's fiscal year, the same rule applies, so long as (1) the company has filed all required Exchange Act reports, (2) for the most recent fiscal year for which audited financial statements are not yet available the company reasonably and in good faith expects to report income after taxes but before extraordinary items and a cumulative effect of a change in accounting principle, and (3) for at least one of the two fiscal years immediately preceding the most recent fiscal year the company reported income after taxes but before extraordinary items and cumulative effect of a change in accounting principle.

The SEC has modified this provision for accelerated filers. For non-accelerated filers the rule will not change. For accelerated filers, the 45 to 90 day period will remain for the first year, will become a 45 to 75 day period in the second year, and will become a 45 to 60 day period in the third year, as follows:

Fiscal Year	Period

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Fiscal years ending on or after December 15, 2002 and before December 15, 2003	45 to 90 day period
Fiscal years ending on or after December 15, 2003 and before December 15, 2004	45 to 75 day period
Fiscal years ending on or after December 15, 2005	45 to 60 day period

2. Changes to Filings Made After 134 Days After Fiscal-Year End.

Under current rules, for filings (such as Securities Act registration statements) made after 134 days subsequent to the end of a company's most recent fiscal year, the filing must also include a balance sheet as of an interim date within 135 days of the date of filing.

The SEC has modified this provision for accelerated filers. For non-accelerated filers the rule will not change. For accelerated filers the new rule is as follows:

For Fiscal Years Ending	For Filings Made After the Following Number of Days After the Fiscal Year End	Balance Sheet Must be Within the Following Number of Days of the Date of the Filing
On or After December 15, 2002 and Before December 15, 2004	Filing made after 134 days after fiscal year end	Within 135 days of the date of the filing
On or After December 15, 2004 and Before December 15, 2005	Filing made after 129 days after fiscal year end	Within 130 days of the date of the filing
On or After December 15, 2005	Filing made after 124 days after fiscal year end	Within 125 days of the date of the filing

3. Age of Financial Statements at Effective Date of Registration Statements.

Under current rules, if the financial statements in a filing are as of a date 135 days or more prior to the date the filing is expected to become effective or the proposed mailing date of a proxy statement, the financial statements must be updated with a balance sheet as of an interim date within 135 days and with statements of income and cash flows for the interim period between the end of the most recent fiscal year and the date of the interim balance sheet provided. As described above, special provisions apply during the 90 (or 75 or 60) days following the end of the company's fiscal year.

The 135-day rule in Rule 3-12 of Regulation S-X has been modified for accelerated filers. For non-accelerated filers, the 135-day rule will not change. For accelerated filers, the rule is as follows:

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For Fiscal Years Ending	If financial statements are as of the following number of days prior to the effectiveness date	Balance sheet must be as of an interim date within the following number of days
On or After December 15, 2002 and Before December 15, 2004	135 days or more prior to effectiveness date	135 days
On or After December 15, 2004 and Before December 15, 2005	130 days or more prior to effectiveness date	130 days
On or After December 15, 2005	125 days or more prior to effectiveness date	125 days

4. No Change Made to Deadline for Proxy Statement.

The proxy statement or information statement for the election of directors may still be filed within 120 days after the end of the fiscal year. Notwithstanding the accelerated Form 10-K deadline, relevant sections of the proxy statement filed within 120 days after the end of the fiscal year can be incorporated by reference into the Form 10-K. However, consistent with current rules, if an issuer files its Form 10-K under the accelerated deadline and at that time desires to have a Securities Act registration statement declared effective, the issuer would be required to either file the proxy statement early or include in the registration statement or Form 10-K the items that would have been incorporated by reference into the Form 10-K from the proxy statement.

5. No Change Made to Deadline for Filing Acquired Entity Financial Statements.

Form 8-K allows public companies to delay filing financial statements of acquired entities for up to 75 days following completion of the acquisition. In addition, Rule 3-05 of Regulation S-X permits registration statements to omit the financial statements of acquired entities for up to 74 days under specified circumstances. The SEC's new rules do not change these provisions.

Practice tip

Some corporate agreements, such as loan agreements, routinely contain provisions triggering an event of default if timely securities filings are not made. In-house counsel must take care to make sure a failure to file doesn't trigger any significant obligations under these documents.

6. Web Posting Requirements

The new rules require accelerated filers to disclose the following information in their Form 10-K for fiscal years ending on or after December 15, 2002:

- the issuer's Internet address, if it has one;

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- whether the issuer makes available free of charge on or through its Internet website its annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to the foregoing as soon as reasonably practicable after electronically filed with or furnished to the SEC;
- if the issuer does not make filings available in this manner, the reasons why not, including where applicable that the issuer does not have an Internet website; and
- if the issuer does not make filings available in this manner, whether it voluntarily will provide electronic or paper copies of its filings free of charge upon request.

This disclosure is only required in Form 10-K and is not required in any registration statement or any other filing. Also, it only applies to accelerated filers. Accordingly, the disclosure requirement does not apply to foreign private issuers who file annual reports on Form 20-F. The SEC release states the disclosure requirement is not an antifraud rule, does not create new duties under the federal securities laws, does not create a new private right of action, and does not create or affect a company's duty to update its prior statements. Finally, the rules only create a disclosure obligation but do not require that the issuer maintain a website or include periodic reports on the website.

The SEC's adopting release provides the following interpretative guidance regarding inclusion of periodic reports on an issuer's website:

- The disclosure must indicate if reports are available on or through the issuer's website. This means that the reports are posted directly on the issuer's website, the reports can be hyperlinked from a third party vendor, or the website can simply hyperlink to the SEC's Edgar website.
- Hyperlinking to a third party service is acceptable so long as the reports are made available in the appropriate time frame and access to the reports is free of charge to the user. The hyperlink should be directly to the issuer's reports or a page listing the issuer's reports and not just to the home page or general search page of the third party service.
- If a hyperlink is used, it is acceptable to have an intervening screen indicating to viewers that they are leaving the issuer's website. It is also acceptable to disclaim responsibility for the accuracy of the third party service (for purposes of the disclosure requirement).
- The disclosure must state if reports are available on the issuer's website as soon as reasonably practicable. The SEC release states that they interpret as soon as reasonably practicable to mean on the same day the document is filed, barring unforeseen circumstances.
- Companies may display reports on their websites in a format (such as PDF) which differs from the SEC's official EDGAR format so long as (1) the format enhances readability and accessibility of the report, (2) all of the information in the report remains retrievable, and (3) the medium is not so burdensome that the intended recipients cannot effectively access the information provided.
- Disclosure that reports are available means that viewers have access to all exhibits and schedules electronically filed with the reports. Material incorporated by reference is not required to be separately posted (although the SEC encourages this).
- The SEC release suggests that reports should be available at least for a 12-month period and states that it is desirable for companies to provide access to previous reports on an archived portion of their website over an even longer timeframe.

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- The release states that inclusion of the company's website address in the Form 10-K will not, by itself, include or incorporate by reference the information on the site into the Form 10-K itself.

For companies with multiple websites, the Form 10-K should disclose the website that the company normally uses for its investor relations functions.

D. 8-Ks

As stated in the SEC's adopting release:

> Under the previous Form 8-K regime, companies were required to report very few significant corporate events. The limited number of Form 8-K disclosure items permitted a public company to delay disclosure of many significant events until the due date for its next periodic report. During such a delay, the market was unable to assimilate such undisclosed information into the value of a company's securities. The revisions that we adopt today will benefit markets by increasing the number of unquestionably or presumptively material events that must be disclosed currently. They will also provide investors with better and more timely disclosure of important corporate events.

The goal of the SEC with these amendments to Form 8-K is to implement the "real time issuer disclosure" mandate contained in Section 409 of SOX. In addition, the SEC reorganized the filing numbers to provide more accurate information to anyone seeking information about an issuer. These new disclosure requirements went into effect on August 23, 2004 and are applicable to all issuers.

Under the old 8-K rules, this filing of an 8-K was generally required within either five business days or fifteen calendar days of the occurrence of certain events. Under the new rules, filings will generally be required within four business days after the occurrence of the reportable event. The SEC expanded two existing disclosure requirements to now include:

- The departure of any director or principal officer, or the election of any director other than by shareholder vote, and the appointment of principal officers.
- Any amendment to an issuer's articles or by-laws if the issuer did not propose the amendment in a previously filed proxy statement or any change in fiscal year other than by a shareholder vote or article or by-law amendment.

The SEC also added eight new disclosure items to Form 8-K:

- The entry into or amendment of a material definitive agreement not made in the ordinary course of business.
- The termination of a material definitive agreement not made in the ordinary course of business.
- The creation of a material direct financial obligation or an obligation under an off balance sheet arrangement, whether or not the Company is a party to the agreement.
- The occurrence of any event causing the increase or acceleration of a direct financial obligation of the issuer with respect to any off balance sheet arrangement.

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- Exit or disposal activities pursuant to which the issuer will incur material charges.
- A decision by the issuer that it must recognize a material impairment charge to any of its assets, including goodwill, under GAAP.
- The receipt of any notice of delisting or failure to satisfy a continued listing rule or standard.
- Any determination by the issuer that investors should no longer rely on previously issued financial statements.

In addition, items that were previously reportable on Forms 10-K or 10-Q must now be reported on Form 8-K:

- Unregistered sale of equity securities by the Company equivalent to at least one percent of the outstanding class.
- Any material modification to the rights of holders of the issuer's registered securities.

E. Summary of Changes

- Annual reports on Form 10-K will have to be filed within 60 calendar days after the end of the fiscal year instead of the current 90 days.
- Quarterly reports on Form 10-Q will need to be filed within 35 calendar days after the end of the fiscal quarter, instead of the current 45 days, beginning December 31, 2005.
- The 8-K filing deadline for most items is shortened to four business days, and there is a significant increase in disclosure obligations.
- Web Posting — An issuer will also have to disclose the following in its annual reports on Form 10-K:
- Web site address (if applicable)
- Whether it is making available, free of charge, on or through its Web site (if applicable):
- Annual Report on Form 10-K
- Quarterly Reports on Form 10-Q
- Current Reports on Form 8-K
- All amendments to those forms
- Reasons company is not making its filings available on its Web site (if applicable)
- Whether company is providing electronic or paper copies of filings free of charge upon request in lieu of posting the information on its Web site

Practice tip:

> *In-house counsel must stay on top of the new filing requirements and deadlines and maintain or participate in an orderly plan for the preparation and filing of all of the periodic reports. Because so many different groups have input into the periodic reports, it may be helpful for in-house counsel to establish a time and responsibility table for each filing as well as a procedure for determining when 8-K filings are to be made. While the new 8-K rules do provide a limited safe harbor, in-house counsel should not rely on this and instead should make every effort to have these filings made when due.*

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VII. Disclosure Procedures and Internal Controls

A. General Overview

Some of the most significant aspects of SOX are the requirements relating to disclosure controls and procedures and internal control over financial reporting. These requirements are far-reaching efforts to improve the accuracy, quality and timeliness of both financial and non-financial disclosure by public companies. Much publicity has been given to the scope and associated costs of complying with these requirements, especially the internal controls rules under SOX Section 404[11].

While the near-term results of these new rules are clear in terms of the significantly increased burdens on public companies to design, maintain and regularly assess their procedures and controls over financial reporting and disclosure, as well as significantly increased costs of compliance, the longer term effects of the rules remain to be seen. Following the first major set of internal controls reports by public companies and concurrent widespread complaints of burdensome audit requirements and extremely high compliance expenditures, both the SEC and the Public Company Accounting Oversight Board (PCAOB)[12] have taken steps to address the perceived problems with the new rules, including the burdens on smaller public companies.[13] The tension between regulators' aims to provide investors assurance of adequate control environments and the high regulatory compliance costs required to achieve those aims will likely be played out in the next several years.

B. Disclosure Controls and Procedures

1. Definitions and Scope.

In connection with the rules requiring periodic certifications from Chief Executive and Chief Financial Officers of public companies[14], the SEC adopted rules requiring each public company to maintain "disclosure controls and procedures."[15] These procedures are defined as:

> *controls and other procedures of an issuer that are designed to ensure that information required to be disclosed by the issuer in the reports it files or submits under the [Exchange] Act is recorded, processed, summarized and reported, within the time periods specified in the [SEC's] rules and forms.*[16]

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[11] *See*, *e.g.*, Paul Goes, *Costs of Accounting Rules Remain on the Rise*, Milwaukee J. Sentinel, June 17, 2005, at D1; Ellen Rosen, *Not-Giants Seek Relief from Cost of New Audit Rules*, N.Y. Times, June 16, 2005, at C1; Andrew Countryman, *Sarbanes-Oxley Mandates Send Corporate Audit Expenses Soaring*, Chi. Trib., June 5, 2005, at C1; Deborah Solomon, *Accounting Rule Exposes Problems But Draws Complaints about Costs*, Wall St. J., March 2, 2005, at A1.

[12] The Public Company Accounting Oversight Board is the governing body established by SOX to oversee accountants for public companies.

[13] *See* SEC Division of Corporate Finance, Office of Chief Accountant, Staff Statement on Management's Report on Internal Control Over Financial Reporting (May 16, 2005); PCAOB Release No. 2005-009, Policy Statement Regarding Implementation of Auditing Standard No. 2, *An Audit of Internal Control over Financial Reporting Performed in Conjunction with an Audit of Financial Statements* (May 16, 2005). The SEC has also convened a panel to focus on the effects of the new regulatory burdens on smaller public companies. *See* SEC Release Nos. 33-8514 and 34-50864, Notice of Establishment of the Advisory Committee on Smaller Public Companies.

[14] Discussed in detail in Section VIII, below.

[15] Exchange Act Rules 13a-15 and 15d-15.

[16] Exchange Act Rules 13a-15(e) and 15d-15(e).

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The SEC additionally defined the procedures as those designed to ensure that information required to be disclosed in SEC reports is "accumulated and communicated to the issuer's management, including its principal executive and principal financial officers…as appropriate to allow timely decisions regarding required disclosure."[17]

It is important to note that the disclosure controls and procedures rules apply to all Exchange Act reports, which include annual reports on Form 10-K, quarterly reports on Form 10-Q, proxy materials and, most notably, current reports on Form 8-K. Effective August 2004, the SEC amended the Form 8-K rules to require disclosure of several additional events, generally within four business days of their occurrence.18 Effective disclosure controls and procedures should therefore require prior or contemporaneous notice of these events to appropriate disclosure personnel to ensure disclosure on Form 8-K within the four day period.

Disclosure controls and procedures is a broad concept which encompasses the procedures and processes by which all information, including financial information, business developments and risk factors, is collected, evaluated and reported by public companies. Due in part to this breadth, the concept of disclosure controls differs from internal control over financial reporting (discussed below), which focuses on financial information. Because it applies to all Exchange Act reports, including proxy statements and Form 8-Ks that might be filed any time during a company's fiscal year, the concept is also broader than the certifications required of CEOs and CFOs, which are made only on a quarterly basis. The SEC has already brought actions against public companies for failure to maintain adequate disclosure controls and procedures.19

2. Management Evaluations.

a. Timing

Management of public companies is required to evaluate the effectiveness of their disclosure controls and procedures as of the end of the period covered by each Exchange Act report containing the CEO/CFO certifications.[20] This would be the end of each fiscal quarter for U.S. public companies. The company's principal executive and financial officers must participate in the evaluation.[21]

Due to the timing requirement of the disclosure controls evaluation, effective disclosure controls and procedures will include a preliminary evaluation earlier in the quarter, to allow the company to correct any deficiencies before the required final evaluation. If the company has a formal disclosure committee, it would be the appropriate body to conduct the evaluation. If there is no disclosure committee, the company personnel in charge of disclosure matters should conduct the evaluation.

b. Required Disclosure.

Under Regulation S-K Item 307, a public company's quarterly (10-Q) and annual (10-K) reports must contain disclosure regarding the conclusions of the principal executive and financial officers of the effectiveness of disclosure controls and procedures.[22] The conclusions must be based upon the

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[17] Id.
[18] *See* SEC Release Nos. 33-8400 and 34-49424 (March 16, 2004); SEC Release Nos. 33-8400A and 34-49424A (August 4, 2004).
[19] *See* complaint in SEC v. Siebel Systems, Kenneth Goldman, Mark D. Hanson (S.D.N.Y., June 29, 2004), available at http://www.sec.gov.litigation/complaints/comp18766.pdf.
[20] Exchange Act Rules 13a-15(b) and 15d-15(b).
[21] Id.
[22] Regulation S-K, Item 307

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evaluations performed as of the end of each quarter.

3. Practice Tips

a. Criteria for Procedures.

The breadth and timing matters involved in the disclosure controls and procedures requirements dictate that public companies give thoughtful attention to the ways they compile information for SEC reports, the personnel involved in reporting, gathering and evaluating information for those reports, the knowledge of such personnel of the SEC rules and disclosure requirements and the time frames under which various reports need to be prepared.

Each public company is different, and effective disclosure controls and procedures should take into account individual circumstances, including the company's size and management structure, employee knowledge of legal standards and customary internal information flows in creating effective procedures and controls. Companies should especially examine past weaknesses in the timing, accuracy or completeness of required disclosure in preparing its procedures. Bearing the individual company circumstances in mind, some of the best disclosure controls and procedures will involve the following general criteria:

- the procedures are written;
- senior management is involved in the design and functioning of the procedures;
- one or more members of senior management (including, if created, a disclosure committee) should be in charge of the disclosure function;
- timing considerations are clearly spelled out, with "disclosure calendars" for periodic reports and specific controls and procedures relating to the required Form 8-K disclosure items;
- a sufficient number of employees should be subject to the procedures to provide assurance that relevant information is delivered for evaluation by senior management; and
- the evaluation of the controls should be a formal procedure conducted by senior management on a quarterly basis.

b. Documentation

Documenting disclosure controls and procedures is necessary for several reasons, including emphasizing the importance of the procedures themselves to management and employees and providing an organized, clearly-described structure for information gathering, evaluation and reporting. Sample VII-1 contains a sample for written disclosure procedures and policies and checklists for associated disclosure control timelines. As stated above, each company must evaluate its own particular circumstances, personnel and structure in developing effective disclosure controls and procedures. Some recommended elements for written procedures include:

- the personnel covered by the procedures;
- a list of the relevant disclosure personnel and their respective functions within the disclosure procedures;
- the SEC reports required to be filed by the company and the time period requirements for filing of each;
- a description of materiality standards or references to applicable standards;
- the methods by which potentially relevant information is communicated;

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- a "disclosure calendar" with timelines for gathering and evaluating information from various business units and functions, preparation and review of the reports by management, the company's audit committee, outside legal counsel and outside accountants; and
- specific procedures and controls relating to the Form 8-K disclosure requirements.

c. Disclosure Committees

In its adopting release regarding disclosure controls and procedures, the SEC recommended that public companies have a disclosure committee comprised of employees whose function is to oversee the company's disclosure.[23] In general, depending upon the powers granted to it, the disclosure committee reviews the information gathered in accordance with the company's procedures and determines materiality and timing matters with respect to disclosure. The SEC further recommended that, to the extent companies decide to have a formal disclosure committee, it consider including the principal accounting officer or controller, the general counsel, the principal risk management officer and the chief investor relations officer as members.[24]

The SEC's position is a recommendation, not a mandate. In determining whether a formal disclosure committee is appropriate or necessary, a public company should consider the general scope and complexity of their disclosure, how decisions about disclosure are made, whether an informal structure may function more efficiently and who among the company's personnel has the legal and technical knowledge to make the determinations a disclosure committee regularly makes.

d. Gathering Information

In fashioning disclosure controls and procedures, companies should give due consideration to the manner in which potential disclosure information is gathered and assessed. These procedures, in a level of complexity suitable for the particular company, should be part of the documented controls and procedures described above.

In order to gather information effectively, simply imposing reporting obligations on various personnel may not be sufficient. Those personnel must also have an adequate understanding of the relevant reporting requirements both to assess information they encounter and to relay to subordinates the importance of reporting certain potential disclosure information "up the chain". Training personnel may therefore be an important step in developing effective disclosure controls and procedures. Training should be tailored as to the specific kinds of disclosure expected of various personnel and should be led by legal counsel, internal or external, well-seasoned in disclosure matters.

The methods by which information is gathered, reported and reviewed is integral to effective disclosure. Again, companies must scrutinize their own particular organizations in determining whether written reports "up the chain" or formal or informal meetings are best to ensure effective disclosure. Employees may balk at a written report requirement due to legal liability concerns. If meetings are the chosen methods for information gathering, consider keeping some form of written record, with sign off by the meeting members if appropriate and acceptable. For information that needs to be reported on a shorter deadline, such as the Form 8-K disclosure items, written reporting may prove to be cumbersome, and oral disclosure to appropriate personnel may be sufficient, or oral followed by written confirmation with supporting documentation may be advisable.

As stated above, senior management, including the CEO and CFO, are required to be a part of the

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[23] *See* SEC Release No. 33-8124, at text accompanying n. 60.

[24] *Id.*

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disclosure procedures. To this end, in addition to CEO and CFO review of all reports covered by the disclosure controls and procedures rules, some companies include disclosure matters as part of regular budget or executive sessions. Other methods involve regularly scheduled review sessions in which the CEO and CFO, following their initial review of periodic reports, can ask questions of personnel involved in the disclosure process. It is recommended that this session take place prior to management's meeting with the company's audit committee regarding the report, so that management can utilize disclosure personnel's input with the audit committee.

e. Verification/Back-Up Certifications

Some public companies require back-up certifications (sometimes referred to as sub-certifications) from certain officers and employees that support the required CEO and CFO certifications relating to disclosure and internal controls under Sections 302 and 906 of SOX.25 As the requirement to provide these certifications has been resisted or caused employee relations problems at certain public companies, it must be imposed with sufficient consideration. In some companies, the requirement to provide back-up certifications lead to further levels of back-up certifications by lower level employees, causing a time-consuming and seemingly needless paper trail.

If back-up certifications are required, management and legal counsel must pay special attention to their coverage scope to avoid liability concerns from the certifying employees. If the employees are already involved in the disclosure process and understand its importance, the back-up certification requirement may be easier to impose. Therefore, companies should consider limiting the back-up certifications to those employees who are covered by, and are primarily responsible for, the disclosure controls and procedures, as reflected in the written policies.

4. Samples and Forms

A sample of written disclosure procedures and policies and associated timeline checklists are contained in Sample VII-1. Forms of recommended back-up certifications are attached as Sample VII-2.

C. Internal Controls

1. Definition of "Internal Control over Financial Reporting" and Coverage of Requirement

Prior to the adoption of SOX, accounting and SEC rules had long imposed requirements on public companies to maintain "internal controls" with respect to their financial and accounting operations.[26] Section 404 of SOX directed the SEC to issue rules requiring management of public companies to assess their "internal controls" and to report on that assessment on an annual basis.[27] The Act also required the SEC to issue rules requiring a public company's auditor to audit the "internal controls" and issue an attestation report on management's assessment.[28]

In connection with its rules issued under SOX Section 404, and in response to the differing definitions of "internal controls" in existence prior to the passage of the Act, the SEC adopted the term "*internal control over financial reporting*." This term refers to a process designed to "*provide reasonable assurance*

[25] *See infra*. Section VIII for a discussion of these certification requirements.
[26] *See, e.g.,* Exchange Act Section 13(b)(2); AICPA Codification of Statements on Auditing Standards § 319.
[27] SOX § 404(a).
[28] SOX § 404(b).

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regarding the reliability of financial reporting and the preparation of financial statements in accordance with generally accepted accounting principles."[29] The process must be designed by, or under the supervision of, the company's principal executive and financial officers.[30] It must be carried out by the company's board of directors and management.

Under the definition, internal controls over financial *reporting* should cover three main areas:

- the maintenance of records that accurately, fairly and in reasonable detail reflect transactions and the dispositions of assets;
- provide reasonable assurance that transactions are recorded so as to permit preparation of financial statements in accordance with generally accepted accounting principles and that receipts and expenditures are made only in accordance with management authorization; and
- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets.

The definition focuses on internal controls over financial reporting, and does not extend to controls over other areas of a company's operations, such as legal compliance, unless those areas relate to the company's financial reporting.

2. Annual Internal Control Report

Every public company is required to include a report on its internal control over financial reporting in its annual report (Form 10-K for U.S. companies).[31] The report must contain three main elements – management responsibilities, statement of evaluation framework, and conclusions about effectiveness.

a. Management's Responsibilities

The annual internal control report must include a statement of management's responsibilities for establishing and maintaining adequate internal control over financial reporting.[32] Management's assessment of internal controls must be conducted by management with the participation of the company's principal executive and financial officers.[33] Although there are no set evaluation procedures to follow, the SEC has stated that management's assessment should involve both an evaluation of the design of internal controls and testing of the controls' effectiveness.[34]

b. Statement of Evaluation Framework

The report must also identify the framework used by management to assess internal control over financial reporting.[35] The framework must be a "suitable, recognized control framework that is established by a body or group that has followed due-process procedures…"[36] The SEC has stated that a report known as the COSO Report[37] provides an assessment framework which meets these requirements.[38]

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[29] *See* Exchange Act Rule 13a-15(f).
[30] Id.
[31] *See* Form 10-K, Item 9A; Regulation S-K Item 308
[32] Regulation S-K, Item 308(a)(1).
[33] Exchange Act Rule 13a-15(c).
[34] *See* SEC Releases Nos. 33-8545 and 34-51293, at paragraph referencing n. 78.
[35] Regulation S-K, Item 308(a)(2).
[36] Exchange Act Rule 13a-15(c).
[37] *The Committee of the Sponsoring Organizations of the Treadway Commission, Internal Control-Integrated Framework* (July 1994).
[38] SEC Release No. 33-8238, at n. 67 and paragraph referencing n. 67.

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c. Conclusions about Effectiveness

Finally, the report must state management's conclusions about the effectiveness of the company's internal controls over financial reporting based upon an evaluation as of the end of the company's most recent fiscal year.[39] Other than certain SEC-permitted exceptions pertaining to the scope of the evaluation, the conclusion may not be qualified in any manner. Although the controls are evaluated as of the end of the fiscal year, the actual evaluation will be conducted over a period of time. Companies are required to provide relatively detailed documentary evidence to back-up their evaluation and conclusion.[40]

Management must disclose any "material weakness" in its internal controls and may not conclude that the controls are effective if any material weakness exists. "Significant weaknesses," a lower level of control problems, generally are not required to be disclosed.

Examples of management internal control reports, including those containing disclosure of material weaknesses, are included as Sample VII-3.

d. Timelines for Compliance with Report Requirements

Larger U.S. companies that fall under the definition of "accelerated filer"[41] were required to include the management report beginning in their annual report on Form 10-K for the first fiscal year ending on or after November 15, 2004. Other, generally smaller, U.S. companies must start to include the report in their annual report on Form 10-K for the first fiscal year ending on or after June 30, 2006.

3. Attestation Report of Auditors and Auditing Standards

The registered public accounting firm[42] that audits a public company's financial statements must also audit the company's internal control over financial reporting and must prepare a report attesting to management's evaluation of those controls.[43] The report must clearly state the opinion of the accountant whether management's assessment of internal controls effectiveness is accurate.[44] The auditor's attestation report must be included in the company's annual report (Form 10-K).[45]

The standards under which accountants audit a public company's internal controls take the form of PCAOB Auditing Standard No. 2. Under the standards, the auditor is required to obtain "reasonable assurance" that the company maintained effective internal control over financial reporting.[46] To do so, the standards require that the auditor test the effectiveness of internal controls as well as assess the process by which management evaluated the controls. In addition, the PCAOB standard requires the auditor to review the effectiveness and independence of the company's audit committee,[47] and requires the specific pre-approval by the audit committee of the engagement of any auditor to provide internal

[39] *See* Exchange Act Rule 13a-15(c); Regulation S-K Item 308(a)(3)
[40] *See* SEC Release No. 33-8238, at paragraph referencing n. 79.
[41] *See* Exchange Act Rule 12b-2. An "accelerated filer" is generally a company with a "public float" of common equity greater than $75 million as of the end of its second fiscal quarter. "Public float" is the market value of common equity held by persons who are not affiliates of the company.
[42] Registered public accounting firms are those accounting firms that have registered with the PCAOB Under SOX, only registered public accounting firms are permitted to audit public companies' financial statements and internal controls and give the related SEC required reports.
[43] Regulation S-X, Rule 2-02(f)
[44] Id.
[45] Regulation S-K, Item 308(b).
[46] PCAOB Auditing Standard No. 2, at paragraph 4.
[47] Id., at paragraphs 55-59.

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control-related services.[48]

The additional audit of internal controls by the registered public accounting firm has a significant impact on public companies in several areas, including the time and expense needed to prepare for and coordinate the audit with the auditor, additional expenses incurred for audit fees, higher standards for management's assessment of internal controls and heightened accountability of the audit committee due to the auditor review requirement. While certain of the problems and higher costs initially encountered by public companies in connection with the audit are being addressed by the SEC and PCAOB[49], the internal control audit will remain a significant compliance hurdle for public companies for the foreseeable future.

4. Quarterly Evaluation and Disclosure

In addition to management's annual report on internal controls, SEC rules require management, with the participation of the company's principal and financial officers, to conduct quarterly evaluations of internal control over financial reporting.[50] These evaluations relate only to changes in the company's internal controls that materially effect, or are reasonably likely to materially effect, the company's internal control over financial reporting.[51] The Company's quarterly reports (Form 10-Qs) must contain a statement that management, including the principal executive and financial officers, have conducted the evaluation, and must disclose any changes in internal controls meeting the rule's requirements.[52] The SEC has provided guidance that companies generally do not have to disclose changes made in preparation for the first report of management on internal controls contained in the company's annual report.[53]

5. SEC Guidance on Recently Acquired Entities

SEC guidance permits companies under certain circumstances to exclude recently acquired entities from the assessment of internal control over financial reporting.[54] If an entity acquired during the most recent fiscal year is excluded from management's assessment, management's annual internal control report must refer to this assessment scope limitation and must identify the acquired entity.[55] The report must also state the significance of the acquired business to the company's consolidated financial statements (in the form of key financial measures such as net assets, revenues and net income).[56] A company cannot exclude any entity from its internal control assessment for a period greater than one

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[48] Id., at paragraph 33. The SEC's auditor independence rules prohibit auditors from providing certain non-audit services to clients. *See* SEC Release No. 33-8238, at paragraph referencing n. 70; Regulation S-X, Rule 2-01(c)(4). As a result of the separation of function rules, auditors can assist management in documenting internal control over financial reporting, but cannot effectively perform the design, maintenance and assessment functions required of management under the rules. *See Id.* Therefore, many public companies have hired one or more additional accounting firms or consultants to assist in the design, maintenance, testing and assessment of internal controls. The engagement of these firms would be subject to the specific pre-approval of the audit committee.

[49] *See supra*, n. 3 and accompanying text.

[50] Exchange Act Rule 13a-15(d).

[51] Id.

[52] *See* Form 10-Q, Item 4; Form 10-K, Item 9A; and Regulation S-K, Item 307. Changes in internal controls occurring in a company's fourth fiscal quarter would be disclosed in the company's annual report on Form 10-K.

[53] Office of the Chief Accountant, Division of Corporation Finance: Management's Report on Internal Control Over Financial Reporting and Disclosure in Exchange Act Periodic Reports – Frequently Asked Questions (revised October 6, 2004), at Question 9.

[54] Id., at Question 3.

[55] Id.

[56] Id.

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year from the date of acquisition.[57] The exclusion does not apply for purposes of disclosing changes to internal controls on a quarterly basis, as discussed above; however, the SEC has stated that a company may disclose all changes to internal controls related to the acquired entity in the first annual report including the management report covering the acquired entity.[58] An example of an internal control report containing a scope exception with respect to a recently acquired entity is included in SampleVII-3.

6. Sample Disclosure

Sample VII-3 includes sample management internal control reports, including those containing material weakness and exclusion of recently acquired entity disclosure. Sample VII-4 contains sample auditor attestation reports.

[57] Id.
[58] Id., at Question 9.

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VIII. Management Certifications under SOX Sections 302 and 906

A. General Background and Overview of Certifications

Congress included in SOX two provisions requiring top management of public companies to certify as to the accuracy of the company's periodic reports, management's assessment of the company's disclosure controls and procedures and matters relating to the company's internal controls. The certification requirements of these provisions, contained in SOX Sections 302 and 906, were amplified and clarified in subsequent regulations and guidance issued by the SEC. Passed in large part in response to testimony from the Enron and WorldCom scandals indicating that top management was (or purportedly was) unaware of various activities materially affecting companies' financial results, the certification requirements are efforts to hold the principal executive and financial officers accountable for public company financial statements and periodic reports.

1. Companies Covered

The Section 302 and 906 certification requirements apply to all U.S. companies required to file periodic reports with the SEC, as well as those companies "in registration" (with pending securities offerings, such as an IPO).[59] In addition, companies who voluntarily file periodic reports with the SEC are subject to the requirements.[60]

2. Filings Covered

For U.S. companies, the certifications must be made in connection with the company's annual report on Form 10-K and each quarterly report on Form 10-Q[61]. The certifications must also be made in connection with the filing of amendments to annual or quarterly reports.[62]

B. Section 302 Certification

1. Content

The Section 302 certification must be made by each of the company's principal executive and financial officers[63] and covers five main certification areas –review of report, material accuracy, fair presentation of financial information, evaluation of disclosure controls and procedures, and internal control over financial reporting -- each discussed below.[64]

a. Review of Report

The certifying officers must each assert that he/she has reviewed the report to which the certification

[59] *See* SOX Section 2(a)(7). The certification requirements apply to "issuers" as defined under the Act.
[60] *See* Sarbanes-Oxley Act of 2002 – Frequently Asked Questions, Division of Corporate Finance (November 8, 2002, revised November 14, 2002), at Question 9.
[61] *See* Exchange Act Rule 13a-14(a); Regulation S-K, Item 601(b)(31)
[62] *See* SEC Release Nos. 33-8124 and 34-46427 (August 28, 2002), at n. 48; Sarbanes-Oxley Act of 2002 – Frequently Asked Questions, Division of Corporate Finance (November 8, 2002, revised November 14, 2002), at Question 4.
[63] *See* Exchange Act Rule 13a-14(a).
[64] *See* Regulation S-K, Item 601(b)(31). The required form of certification is also included in Sample VIII-1 hereto.

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applies. Good practice dictates that, prior to making the certification, each certifying officer should read the report in full, and, as discussed above in Section VII relating to disclosure controls and procedures, should have an opportunity to ask questions of various personnel involved in the disclosure process regarding the report.[65]

b. Material Accuracy of Report

The officer must next certify that, based on his or her knowledge, the report does not contain any material misstatements or omissions or any materially misleading statements. The actual language of the certification is the same as the SEC's general anti-fraud rule, Exchange Act Rule 10b-5. The SEC has stated that the certification applies to information permitted to be incorporated by reference into the report from proxy materials, such as executive compensation information, even if the information is filed after the report is filed.[66]

c. Fair Presentation of Financial Information

The officer must certify that, to his or her knowledge, the financial statements and other financial information contained in the report fairly present, in all material respects, the financial condition, results of operations and cash flows of the company with respect to the periods covered by the report. The certification covers all financial information included in the report, including footnotes and financial data contained in the management's discussion and analysis (MD&A) section.[67]

d. Evaluation of Disclosure Controls and Procedures

The next part of the certification relates to the company's disclosure controls and procedures. The certification must state that :

- the company's principal executive and financial officers are responsible for establishing and maintaining disclosure controls and procedures;
- such officers have designed those controls and procedures, or caused them to be designed, to ensure that material information is disclosed to the certifying officers, particularly with respect to the period covered by the report; and
- such officers have evaluated the effectiveness of the controls and procedures as of the end of the period covered by the report, and have stated their conclusions regarding the effectiveness in the report.

Disclosure controls and procedures are defined and discussed in Section VII.B above.

e. Internal Control over Financial Reporting

The final and most extensive part of the certification covers internal control over financial reporting. The certification must state that:

- the principal executive and financial officers have designed the company's internal control over financial reporting, or caused it to be designed, to provide reasonable assurance of the reliability of the company's financial statements and reporting;
- such officers have disclosed in the report any change in internal control over financial reporting during the period covered by the report that has or is reasonably likely to materially affect such internal control;

[65] *See supra*, Section VII.B.3.d
[66] *See* SEC Release Nos. 33-8124 and 34-46427 (August 28, 2002), at text accompanying n. 57.
[67] Id., at text accompanying n. 56.

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- such officers have disclosed, based on their most recent evaluation of internal control over financial reporting, to the company's auditors and audit committee (a) all significant deficiencies and material weaknesses in internal control over financial reporting that are reasonably likely to adversely affect the company's financial reporting function and (b) fraud of any kind or level involving any employee who has a significant role in internal control over financial reporting.

The certification referred to in the first bullet point above may be omitted until the company is required to include an internal control report and accompanying audit attestation in its annual report. Practically, this means that non-accelerated filers do not have to include this certification until their first annual report for the fiscal year ending on or after June 30, 2006.

The definition of internal control over financial reporting and the related requirements are discussed in Section VII.C above. In addition to certifications as to internal controls, the certification requires a strict statement regarding disclosure of fraud by personnel involved in internal control to the company's auditors and its audit committee. The SEC does not provide a definition of "fraud" in this context, and companies should therefore report any activity that approaches a common-law fraud definition, including instances of aiding and abetting fraud by employees.

2. Mechanics

The SEC has provided very strict rules regarding the mechanics of the Section 302 certification, and has stated that departures from these rules will result in a deficient certification. The following rules apply:

- the certification must be in the exact form contained in the SEC rules with no wording changes; [68]
- the current principal executive and financial officers must each personally sign separate certifications, and the applicable title should be placed under the signature to indicate the position;[69] and
- the certifications should be attached as exhibits to the applicable report.[70]

With respect to the signing officers, a new principal executive or financial officer who assumes the position after the end of the quarter covered by the report but before the filing is required to sign. A person serving as an interim officer for one of the applicable offices at the time of filing must sign. If there are co-officers for the applicable offices, each should sign a separate certification.[71]

C. Section 906 Certification

Congress included a second management certification requirement in SOX under Section 906. This Section added a provision of the Federal Criminal Code requiring certifications of the "chief executive officers" and "chief financial officer" of public companies.[72] The matters covered by the Section 906 certification are substantively the same as matters covered in the Section 302 certification.

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[68] Id., at text accompanying n. 63.
[69] *See* Exchange Act Rule 13a-14(c) and Sarbanes-Oxley Act of 2002 – Frequently Asked Questions, Division of Corporate Finance (November 8, 2002, revised November 14, 2002), at Question 11.
[70] *See* SEC Release Nos. 33-8238 and 34-47986.
[71] *See* Sarbanes-Oxley Act of 2002 – Frequently Asked Questions, Division of Corporate Finance (November 8, 2002, revised November 14, 2002), at Questions 12-16.
[72] 18 U.S.C. § 1350

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1. Content and Covered Reports

The Section 906 certification requires the certifying officers to state two matters:

- the report to which the certification applies fully complies with the SEC requirements applicable to that report; and
- information contained in the report fairly presents, in all material respects, the financial condition and results of operations of the company.

Although upon immediate passage of SOX it was unclear which reports would require the Section 906 certification, the SEC has clarified that the certification is required with each annual report (Form 10-K) and each quarterly report (Form 10-Q).[73]

Unlike the Section 302 certification, no particular form of certification is required. A form of Section 906 certification is included in Sample VIII-1. Both certifying officers can sign the same certificate,[74] although some practitioners see value in having the officers sign separate certificates.

As a criminal provision, penalties attach to violations of the certification requirements only if the certifying officers knowingly make a false certification (see Section VIII.C.3 below). Therefore, many companies include a qualification that the certification is made only to the certifying officers' "knowledge." In making the determination to include a knowledge qualifier, companies should give due consideration to public relations concerns in addition to legal ones.

As a practical matter, due to the substantive similarities between the statements made in the Section 302 and 906 certifications, companies have not (and arguably need not) go beyond the procedures required to make the Section 302 certification in order to make the Section 906 certification.

2. Submission

Initially, in an effort to decrease potential liability relating to the certification, many companies submitted the Section 906 certification as correspondence to the SEC. The SEC subsequently confirmed that the Section 906 certification is required to be submitted as an exhibit to the relevant report.[75] The SEC also confirmed that the certification is deemed "furnished" and not "filed" for purposes of liability for misleading statements in "filed" reports under the Exchange Act,[76] and will not be deemed to be incorporated by reference into registration statements which otherwise incorporate the covered report.[77]

3. Penalties

Officers who knowingly make a false Section 906 certification are subject to a fine of up to $1 million and up to 10 years imprisonment.[78] Officers who knowingly and willfully make a false Section 906 certification are subject to a fine of up to $5 million and up to 20 years imprisonment.[79] The distinction between the two standards is not well settled; however, practically companies and officers

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[73] *See* Sec Release Nos. 33-8400 and 34-49424 (March 16, 2004), at text accompanying nn. 145-46.
[74] *See* Exchange Act Rule 13a-14(b).
[75] *See* SEC Release Nos. 33-8238 and 34-47986 (June 18, 2003); Exchange Act Rule 13a-14(b); Regulation S-K Item 601(b)(32).
[76] *See* Exchange Act Section 18(a).
[77] *See* SEC Release Nos. 33-8238 and 34-47986 (June 18, 2003).
[78] *See* 18 U.S.C. § 1350(c)(1).
[79] *See* 18 U.S.C. § 1350(c)(2).

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should not care greatly about the difference due to the potentially severe penalties for a knowing violation.

The first criminal actions brought by the SEC for allegedly false Section 906 certifications involved several HealthSouth Corporation executives. Certain executives, including a former CEO and a former CFO, plead guilty to the charges.[80] In a celebrated case, Richard Scrushy, founder and CEO of the company, was acquitted in July 2005 of the Section 906 violation charges and a total of 36 criminal counts related to HealthSouth's financial statements and reporting.[81] As a result of the acquittal, the ability of prosecutors to utilize Section 906 to convict certifying officers in the future is unclear.[82]

Practice Tips

> *The ability of officers to confidently make the certifications required to be made under SOX Section 302 and 906 is inherently tied to the effectiveness of the company's disclosure controls and procedures and internal control over financial reporting, discussed above in Section VII. Careful thought and planning into the disclosure and internal controls procedures will lead to effective procedures for the certifying officers to consider disclosure items, review the reports in detail and ask questions of personnel involved in the disclosure processes.*

Because the certifications are made on a quarterly basis under accelerated timing constraints (see Section VI, above), it is very important to provide sufficient report review time for the certifying officers in the disclosure process. Adherence to a carefully planned disclosure schedule which involves the certifying officers along the way, or, at a minimum, allows for complete review of the reports by the certifying officer and the opportunity to ask questions of other personnel, will significantly decrease the potential for erroneous disclosure as well as the anxiety level of the certifying officer with respect to the certifications.

The SEC prescribed form of Section 302 certification and a sample form of Section 906 certification is included in Sample VIII-1. See also Sample VII-2 and the accompanying discussion of back-up certifications in Section VII.A.3, above.

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[80] *See* Kurt Eichenwald, *Key Executive at HealthSouth Admits to Fraud*, N.Y. Times, March 27, 2003, at C1; *HealthSouth CFO Pleads Guilty to Fraud*, L.A. Times, March 27, 2003, at B4; Lisa Fingerot Roth and Adrian Michaels, *Sarbanes-Oxley Speeds HealthSouth Cases*, Fin. Times (USA Ed.), March 31, 2003, at 20.
[81] *See* Dan Morse, Chad Terhune and Ann Carms, *"Clean Sweep: HealthSouth's Scrushy is Acquitted – Outcome Shows Challenges for Sarbanes-Oxley Act; SEC Suit Still Ahead – No Job Offer from Company*, Wall St. J., June 29, 2005, at A1.
[82] *See Id.* and *Acquittal Casts Cloud over Sarbanes-Oxley in its First Test Law*, Wall St. J., June 29, 2005, at A8.

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IX. Code of Ethics

A. Overview

As defined in further detail below, a code of ethics is a statement of a company's standards for promoting ethical behavior and compliance with applicable laws. In general, a code should not focus solely on the minimum requirements of laws and regulations. Rather, in drafting a code, in-house counsel should strive to meet industry best practices.

B. Legal Requirements

The requirements pertaining to codes of conduct and ethics in SOX and the SEC regulations apply to all publicly traded companies. More specifically, however, the NYSE and NASD have adopted their own rules on codes of conduct. Thus, it is important to adhere to the specific listing rules of the exchange at which a company's securities are listed, as well as federal laws and regulations.

1. Section 406 of SOX and Implementing Regulations

SOX requires companies to disclose whether they have adopted a code of ethics for their senior financial officers, including the principal financial officer, comptroller, principal accounting officer and any other individuals who perform similar duties.[83] The implementing regulations also call for the code to apply to the principal executive officer.[84]

Under SOX, a "code of ethics" is defined to as "standards as are reasonably necessary to promote—

> a. honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships;
> b. full, fair, accurate, timely, and understandable disclosure in the periodic reports required to be filed by the issuer; and
> c. compliance with applicable governmental rules and regulations."[85]

Regulations go further, requiring that codes of ethics promote (a) "[t]he prompt internal reporting of violations of the code to an appropriate person or persons identified in the code," and (b) "[a]ccountability for adherence to the code."[86]

2. NASD

The NASD recently promulgated rules that relate to corporate governance reforms, including codes of conduct.[87] Specifically, issuers "shall adopt a code of conduct applicable to all directors, officers and employees, which shall be publicly available."[88] The purpose of codes of conduct is "to demonstrate to investors that the board and management of NASDAQ issuers have carefully considered the requirement of ethical dealing and have put in place a system to ensure that they become aware of and

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[83] § 406(a).
[84] 17 C.F.R. § 229.405(a). If a company does not have a code of ethics, it must explain the reasons why. See 17 C.F.R. § 229.406(a); Sarbanes-Oxley § 406(a).
[85] Sarbanes-Oxley § 406(c).
[86] 17 C.F.R. § 229.406(b)(4)-(5).
[87] The rule requiring companies to adopt codes of conduct became effective on May 4, 2004. NASD R. 4350(a)(5).
[88] NASD R. 4350(n).

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take prompt action against any questionable behavior."[89] Codes of conduct also serve to assure employees "that reporting of questionable behavior is protected and encouraged, and fosters an atmosphere of self-awareness and prudent conduct."[90]

Such codes "must comply with the definition of a 'code of ethics' set out in Section 406(c) of the Sarbanes-Oxley Act of 2002 … and any regulations promulgated thereunder."[91] In other words, the code "must include such standards as are reasonably necessary to promote the ethical handling of conflicts of interest, full and fair disclosure, and compliance with laws, rules and regulations, as specified by" SOX.[92] A code of conduct must also "contain an enforcement mechanism that ensures prompt and consistent enforcement of the code, protection for persons reporting questionable behavior, clear and objective standards for compliance, and a fair process by which to determine violations."[93]

3. NYSE

The NYSE rule regarding codes of conduct merely states: "Listed companies must adopt and disclose a code of business conduct and ethics for directors, officers and employees, and promptly disclose any waivers of the code for directors or executive officers."[94] However, the commentary to the rule goes into more detail regarding the purpose and requirements of codes of conduct. For example, the goal of a code of conduct should be to "focus the board and management on areas of ethical risk, provide guidance to personnel to help them recognize and deal with ethical issues, provide mechanisms to report unethical conduct, and help to foster a culture of honesty and accountability."[95]

The commentary goes on to list various requirements of codes of conduct. For instance, a comprehensive code:

- "must require that any waiver of the code for executive officers or directors be made only by the board or a board committee and must promptly be disclosed to shareholders";[96]
- "must … contain compliance standards and procedures that will facilitate the effective operation of the code";
- must be included on a listed company's website and be available in print to any shareholder who requests it.[97]

Regarding specific risk areas, the NYSE rules emphasize—rather than mandate—that "all listed companies should address the most important topics," which include conflicts of interest; corporate opportunities; confidentiality; fair dealing; protection and proper use of company assets; compliance with laws, rules and regulations (including insider trading laws); and encouraging the reporting of any illegal or unethical behavior.[98]

4. U.S. Sentencing Guidelines

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[89] NASD IM-4350-7.
[90] Id.
[91] NASD R. 4350(n).
[92] NASD IM-4350-7.
[93] Id.
[94] NYSE R. 303A.10.
[95] NYSE R. 303A.10 cmt.
[96] The NYSE's Frequently Asked Questions document related to the new rules explains that the prompt disclosure required may be satisfied by "[t]he distribution of a press release within 2-3 business days" of the board's decision, the publication of the decision on the company's website, or notification to the SEC on a company's Form 8-K.
[97] NYSE R. 303A.10 cmt.
[98] Id.

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Finally, the U.S. Sentencing Guidelines have had a tremendous impact upon the ubiquitousness of corporate codes of conduct. The Sentencing Guidelines set forth the elements of an effective compliance and ethics program, which can be used to reduce an organization's sentence.[99] Among the essential elements of a comprehensive compliance and ethics program are two with a direct bearing on the existence and use of a code of conduct. First and foremost, an effective program requires written "standards and procedures to prevent and detect criminal conduct."[100] Included within these standards should be a corporation's code of conduct. The second element that relates to codes of conduct is the requirement that an effective program communicate and train its employees on its various standards and policies, including those explained in the code of conduct.[101]

It is critical to note that the mere existence of a written code is not enough to satisfy the Sentencing Guidelines requirements. It should be remembered that Enron seemed to have in place all of the elements of an effective compliance and ethics program, including a code of conduct. It turned out, however, that all Enron had was a "paper" compliance program, and nothing of substance.[102] In making both charging and sentencing decisions, the government will look beyond the surface of a corporation's written policies and codes in order to determine whether an actual culture of compliance and ethics exists.

C. Persons Subject to the Code of Ethics

As explained above, SOX requires codes of ethics to apply only to senior financial officers.[103] In contrast, the requirements of the NASD and NYSE are broader, requiring the code to apply to all directors, officers, and employees.[104] Again, it is often better to view these requirements as a minimum checklist and then, as a check against that, refer to best practices of the particular industry at issue (for example, some companies choose to have their codes apply to agents or independent contractors as well).

D. Public Availability of Code of Ethics

Merely having a code of ethics is not all that the law requires; rather, companies must publicly disclose their codes in one of three ways. A registrant must either:

1. File a copy of the code as an exhibit to the company's annual report;
2. Publish the text of the code on the company's Internet website, also ensuring that (a) the annual report lists the website address and (b) discloses that the company has posted its code at that location; *or*
3. Agree in its annual report to provide without charge a copy of the code to anyone who requests one. The annual report must explain the procedures for requesting a free code.[105]

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[99] See USSG § 8C2.5(f). Moreover, the existence of an effective compliance and ethics program is also used in the government's initial decision whether to charge a corporation. See January 20, 2003 Memorandum from Larry D. Thompson, Deputy Attorney General, available at http://www.usdoj.gov/dag/cftf/corporate_guidelines.htm.
[100] USSG § 8B2.1(b)(1).
[101] Id. at § 8B2.1(b)(4).
[102] See Paul Fiorelli, *Will U.S. Sentencing Commission Amendments Encourage a New Ethical Culture Within Organizations?*, 38 WAKE FOREST L. REV. 565, 567-68 (2004).
[103] § 406(a).
[104] CITE.
[105] See 17 C.F.R. § 229.406(c).

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Many companies have chosen to disclose openly and immediately their codes to the public, posting them on their company websites.

E. Amendments and Waivers

Publicly traded companies must file current reports of material corporate events with the SEC. Among such material corporate events, to be addressed on a company's Form 8-K, are any amendments to the registrant's code of ethics or any waiver of the provisions of the code. Companies have four business days to file an 8-K in the event of either occurrence.

1. Amendments

Companies must be routinely vigilant about updating and amending their codes to take into account changes in applicable laws and regulations. Although companies need not disclose "technical, administrative or other non-substantive amendments,"[106] material and substantive changes must be promptly disclosed on a Form 8-K. Registrants are required to describe briefly the nature of the amendment and note the date on which the amendment occurred.

2. Waivers

A registrant may, on rare, isolated occasions, approve of a waiver, or "material departure from a provision of the code of ethics."[107] The code itself should state the requirements for obtaining a waiver; for example, that only the Board of Directors or the Audit Committee may waive a code provision. A registrant may also, under the most extraordinary circumstances, find that it has failed "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."[108] This failure to act would be deemed an implicit waiver of the code.

Both explicit and implicit waivers must be disclosed on a registrant's Form 8-K. The registrant must describe the nature of the waiver and provide the name of the person who received the waiver, as well as the date of the waiver.[109]

3. Internet Option

Instead of filing a Form 8-K for either an amendment to or waiver of a code provision, a registrant may choose to disclose the necessary information on its website within four business days of the event. The registrant may choose this option only if it has disclosed in its most recent annual report both its Internet address and its decision to provide disclosure of such events on the Internet.[110]

Once an amendment or waiver is posted on the registrant's website, it must remain there, publicly available, for at least one year.[111] Following the one-year period, the registrant must retain the information about the amendment or waiver for at least five years.[112]

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[106] Item 5.05(c)(1).
[107] Item 5.01(c)(2)(i).
[108] Item 5.01(c)(2)(ii).
[109] Item 5.01(b).
[110] Item 5.05(c).
[111] Id.
[112] Id.

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F. Sample Code of Ethics

A sample code of ethics is attached as Sample IX-1. Use Sample IX-1 merely as a guideline or framework from which to start creating a company's own code of ethics. Corporate counsel is strongly cautioned, however, to tailor the company's code to the industry and the culture of the particular company at issue. Without individualization of a code, buy-in from company employees may be lacking. Furthermore, the more effort that management devotes to the adoption of a code, as part of a comprehensive compliance and ethics program, the more likely that others in the organization—as well as government regulators—will view it as a serious commitment to compliance and integrity.

Practice Tips:

- A company's code of ethics should prominently and clearly explain the process by which employees may anonymously and confidentially report any possible ethics concerns or suspected violations of the code.
- It is advisable for companies to issue a form, as an appendix to the code of ethics, which each employee must sign, indicating his or her receipt of the code. The company should retain these signature pages for its records.
- The company should have in place a procedure whereby all individuals subject to the code of ethics receive training on the code. A company should have a sign-in sheet at any training sessions, and those records should be retained.

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X. Shareholder Approval of Equity Compensation Plans

A. Overview

On June 30, 2003, the SEC approved new rules regarding shareholder approval of equity compensation plans. These new rules are applicable to companies listed on both the NYSE and the NASDAQ and take the form of amendments to the listing rules for each exchange. In general, these new rules require that companies listed on either exchange obtain shareholder approval of equity compensation plans, including stock option plans. These new rules are applicable to plans adopted after June 30, 2003, or to plans in existence on that date that are thereafter materially revised. The NYSE has provided significant guidance by posting a series of "frequently asked questions", located at www.nyse.com/equitycompfaqs.pdf.

B. NYSE Rule

As amended, Section 302A(8) of the NYSE Listed Company Manual states:

> **Shareholders must be given the opportunity to vote on all equity-compensation plans and material revisions thereto, with limited exemptions explained below.**
>
> Equity-compensation plans can help align shareholder and management interests, and equity-based awards are often very important components of employee compensation. To provide checks and balances on the potential dilution resulting from the process of earmarking shares to be used for equity-based awards, the NYSE requires that all equity-compensation plans, and any material revisions to the terms of such plans, be subject to shareholder approval, with the limited exemptions explained below.

1. Definition of Equity-Compensation Plan

An "equity-compensation plan" is a plan or other arrangement that provides for the delivery of equity securities (either newly issued or treasury shares) of the listed company to any employee, director or other service provider as compensation for services. Even a compensatory grant of options or other equity securities that is not made under a plan is considered an "equity-compensation plan" for these purposes.

However, the following are not "equity-compensation plans" even if the brokerage and other costs of the plan are paid for by the listed company:

- Plans that are made available to shareholders generally, such as a typical dividend reinvestment plan.

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- Plans that merely allow employees, directors or other service providers to elect to buy shares on the open market or from the listed company for their current fair market value, regardless of whether:
  - the shares are delivered immediately or on a deferred basis; or
  - the payments for the shares are made directly or by giving up compensation that is otherwise due (for example, through payroll deductions).

2. Material Revisions/Repricings

A "material revision" of an equity-compensation plan includes (but is not limited to), the following:

- A material increase in the number of shares available under the plan (other than an increase solely to reflect a reorganization, stock split, merger, spin-off or similar transaction).
  - If a plan contains a formula for automatic increases in the shares available (sometimes called an "evergreen formula") or for automatic grants pursuant to a formula, each such increase or grant will be considered a revision requiring shareholder approval *unless* the plan has a term of not more than ten years. This type of plan (regardless of its term) is referred to as a "formula plan." Examples of automatic grants pursuant to a formula are (1) annual grants to directors of restricted stock having a certain dollar value, and (2) "matching contributions," whereby stock is credited to a participant's account based upon the amount of compensation the participant elects to defer.
  - If a plan contains no limit on the number of shares available and is not a formula plan, then each grant under the plan will require separate shareholder approval *regardless* of whether the plan has a term of not more than ten years. This type of plan is referred to as a "discretionary plan." A requirement that grants be made out of treasury shares or repurchased shares will not, in itself, be considered a limit or pre-established formula so as to prevent a plan from being considered a discretionary plan.
- An expansion of the types of awards available under the plan.
- A material expansion of the class of employees, directors or other service providers eligible to participate in the plan.
- A material extension of the term of the plan.
- A material change to the method of determining the strike price of options under the plan. A change in the method of determining "fair market value" from the closing price on the date of grant to the average of the high and low price on the date of grant is an example of a change that the NYSE would not view as material.
- The deletion or limitation of any provision prohibiting repricing of options.

Note that an amendment will not be considered a "material revision" if it curtails rather than expands the scope of the plan in question.

A plan that does not contain a provision that specifically *permits* repricing of options will be considered for purposes of this listing standard as *prohibiting* repricing. Accordingly any actual repricing of options will be considered a material revision of a plan even if the plan itself is not revised.

"Repricing" means any of the following or any other action that has the same effect:

- Lowering the strike price of an option after it is granted.
- Any other action that is treated as a repricing under generally accepted accounting principles.

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- Canceling an option at a time when its strike price exceeds the fair market value of the underlying stock, in exchange for another option, restricted stock, or other equity, unless the cancellation and exchange occurs in connection with a merger, acquisition, spin-off or other similar corporate transaction.

3. Exemptions

The NYSE Rule does not require shareholder approval of employment inducement awards, certain grants, plans and amendments in the context of mergers and acquisitions, and certain specific types of plans, all as described below. However, these exempt grants, plans and amendments may be made only with the approval of the company's independent compensation committee or the approval of a majority of the company's independent directors. Companies must also notify the NYSE in writing when they use one of these exemptions.

Employment Inducement Awards. An employment inducement award is a grant of options or other equity-based compensation as a material inducement to a person or persons being hired by the listed company or any of its subsidiaries, or being rehired following a bona fide period of interruption of employment. Inducement awards include grants to new employees in connection with a merger or acquisition. Promptly following a grant of any inducement award in reliance on this exemption, the listed company must disclose in a press release the material terms of the award, including the recipient(s) of the award and the number of shares involved.

Qualified Plans and Parallel Excess Plans. A plan intended to meet the requirements of Section 401(a) (such as ESOP's and 401(k) plans) or Section 423 (such as employee stock purchase plans) of the Internal Revenue Code or any parallel excess plan does not require shareholder approval.

4. Mergers and Acquisitions Context

Two exemptions apply in the context of corporate mergers and acquisitions. First, shareholder approval will not be required to convert, replace or adjust outstanding options or other equity-compensation awards to reflect the transaction. Second, shares available under certain plans acquired in corporate acquisitions and mergers may be used for certain post-transaction grants without further shareholder approval. This exemption applies to situations where a party that is not a listed company following the transaction has shares available for grant under pre-existing plans that were previously approved by shareholders. A plan adopted in contemplation of the merger or acquisition transaction would not be considered "pre-existing" for purposes of this exemption.

Shares available under such a pre-existing plan may be used for post-transaction grants of options and other awards with respect to equity of the entity that is the listed company after the transaction, either under the pre-existing plan or another plan, without further shareholder approval, so long as:

- the number of shares available for grants is appropriately adjusted to reflect the transaction;
- the time during which those shares are available is not extended beyond the period when they would have been available under the pre-existing plan, absent the transaction; and
- the options and other awards are not granted to individuals who were employed, immediately before the transaction, by the post-transaction listed company or entities that were its subsidiaries immediately before the transaction.

Any shares reserved for listing in connection with a transaction pursuant to either of these exemptions

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would be counted by the NYSE in determining whether the transaction involved the issuance of 20% or more of the company's outstanding common stock and thus required shareholder approval under Listed Company Manual Section 312.03(c).

These merger-related exemptions will not result in any increase in the aggregate potential dilution of the combined enterprise. Further, mergers or acquisitions are not routine occurrences, and are not likely to be abused. Therefore, the NYSE considers both of these exemptions to be consistent with the fundamental policy involved in this standard.

5. Broker Voting

In addition, the NYSE will preclude its member organizations from giving a proxy to vote on equity-compensation plans unless the beneficial owner of the shares has given specific voting instructions. This is codified in NYSE Rule 452. Amended Rule 452 will be effective for any meeting of shareholders that occurs on or after the 90th day following the date of the SEC order approving the rule change. The NASDAQ Rule does not specifically address this issue, but NASD rules generally prohibit discretionary voting by brokers without specific restrictions from the beneficial owner.

C. NASDAQ Rule

The NASDAQ Rule appears as Rule 4350(i)(1)(a) in the NASDAQ Listing Manual. In general, the NASDAQ Rule and the NYSE Rule are substantially identical with a few minor differences. The NASDAQ Rule does not address repricings specifically, but instead provides that material amendment to a plan would include any material increase in benefits to a participant, including any reduction in the exercise price of outstanding options or the price at which shares or options to purchase shares may be offered. The NASDAQ Rule does not require written notification when a listing company relies on one of the exemptions to the shareholder approval requirement and the NASDAQ Rule does not adopt the NYSE position that a plan that does not contain a provision specifically permitting the repricing of options is deemed to prohibit repricings. The NASD Rule does adopt the NYSE approach that pre-existing plans adopted prior to June 30, 2003 cannot be materially revised without shareholder approval, although it does not include the detailed guidance contained in the NYSE Rule.

D. Summary

In-house counsel at any issuer that has in place or plans to adopt an equity compensation plan must pay particular attention to these new requirements. The effort, time and expense required in obtaining the necessary shareholder approval for the material revision of an existing plan or adoption of a new plan must be considered early in the process. Further, in-house counsel should carefully review any existing plans that provide for automatic or matching grants to ensure that future grants do not violate these new rules, with particular emphasis on the term of "evergreen" plans (not to exceed ten years) and share limitations on discretionary plans which may require approval for each additional grant.

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XI. New Deadlines for Insider Transaction Reports

A. Overview

In connection with SOX, Congress took measures to correct perceived deficiencies in the disclosure of information regarding transactions in public company stock by company insiders – directors, officers and major stockholders. Prior to the passage of SOX, insiders were required to report many transactions as late as 10 days following the month in which the transaction took place, and many other transactions as late as 45 days following the end of the fiscal year in which the transaction took place. Investors complained that the system did not provide timely information to the public about the trading activities of insiders, information that many investors view as material in making investment decisions.[113]

Congress responded by passing extensive amendments to Section 16 of the Exchange Act.[114] Section 16 requires a public company's "insiders" -- directors, officers and persons beneficially holding greater than 10% of a class of a company's equity securities -- to file reports on Exchange Act forms 3, 4 and 5 to report transactions in the company's securities.[115] As described below, the Section 16 amendments significantly decreased the time by which insiders must file the relevant forms, required electronic filing of all Section 16 reports and required company website posting of all such reports.

B. Shorter Deadline Requirements

1. Two Business Day Requirements

Exchange Act Section 16(a) and related SEC rules require persons who become insiders of a public company to file a Form 3 (Initial Statement of Ownership) within 10 calendar days of the date they become an insider. The Form 3 reports all beneficial holdings in company securities by the insider as of the date insider status commences.[116] Following the filing of a Form 3, insiders are generally required to report all other transactions in company securities, either on a Form 4 (Statement of Changes of Beneficial Ownership of Securities) or a Form 5 (Annual Statement of Beneficial Ownership of Securities).

The SEC amendments to Section 16 under SOX require that most transactions in company securities by insiders be reported on a Form 4 within *2 business days* of their occurrence.[117] The two day requirement applies to transactions including:

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[113] *See, e.g.,* Casell Bryan-Low, *Bill Cuts Filing Time by Insiders*, Wall St. J., September 9, 2002, at C3; Krissah Williams, *SEC Tightens Deadlines on Corporate Disclosure; Executives Must Report Trades in 2 Days*, Wash. Post, August 28, 2002, at E1.

[114] SOX Section 403

[115] Exchange Act Section 16(a)(1); Exchange Act Rules 16a-2 and 16a-3.

[116] For purposes of initially determining whether a person beneficially holds more than 10% of a class of equity securities under Section 16, beneficial ownership means directly or indirectly holding or sharing the power to dispose of the securities or to vote the securities. *See* Exchange Act Rule 16a-1(a)(1). For all other purposes under Section 16 (e.g., beneficial ownership by directors and officers), beneficial ownership means directly or indirectly holding or sharing a direct or indirect pecuniary interest in the securities. *See* Exchange Act Section 16a-1(a)(2).

[117] Exchange Act Section 16(a)(2)(C); Exchange Act Rule 16a-3(g).

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- securities acquired directly from the company, including grants of stock options and other types of equity awards;
- dispositions of securities to the company;
- employee benefit plan transactions in which the insider can determine the date of execution; and
- stock option cancellations and repricings.

2. Limited Exceptions.

The SEC extended the two-day deadline for two categories of transactions:

- transactions pursuant to Rule 10b5-1 plans in which the insider does not determine the date of execution;[118] and
- certain employee benefit plan transactions when the insider does not choose the execution date.

These transactions are required to be reported within two business days of the date the insider is notified of the transaction, and such notification must occur no later than three days from the actual date of the transaction.[119]

3. Use of Form 5/Exemptions for Reporting

Due to the Section 16 amendments, the use of Form 5 (used for reporting certain transactions up to 45 days after the company's fiscal year end) has been significantly curtailed. Transactions still allowed to be reported on Form 5 include gifts and other transfers by will and acquisitions of securities other than from the company or through an employee benefit plan with a market value less than $10,000.[120]

Under the Section 16 rules, certain "non-discretionary" transactions, including those under certain tax exempt benefit plans, issuances of stock dividends, and transactions under dividend reinvestment plans, are exempt from reporting altogether.[121]

C. Mandated Electronic Filing and Website Posting

The Section 16 amendments require that every Section 16 report be filed electronically with the SEC.[122] The SEC established a new web-based filing system through which the reports must be filed. Companies must also post each Section 16 report on their website by the end of the business day on which it is filed and keep it there for at least twelve months following filing.[123] To fulfill this requirement, companies are permitted to provide a link on their website to the report as filed on the

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[118] Rule 10b5-1 plans are written plans by directors and officers that provide for future sales or purchases of company securities under specified circumstances, e.g., a purchase when the stock reaches a certain price, or sale of a certain volume of shares per day over a specified number of trading days. The plans are commonly entered into with an insider's broker, and the broker carries out the trades subject to the plan's specifications. Under Exchange Act Rule 10b5-1, trades made in accordance with a plan meeting the requirements of the rule are generally exempt from insider trading rules.

[119] Exchange Act Rule 16a-3(g)(2)-(4).

[120] Exchange Act Rules 16b-5, 16a-6 and 16a-3(f).

[121] *See generally* Exchange Act Rule 16b-3. The rules regarding these exempted transactions are highly complex, and practitioners are cautioned to consult experienced securities counsel regarding them.

[122] *See* SOX Section 403(a), Exchange Act Section 16(a)(4) and Exchange Act Rule 16a-3(k).

[123] Id.

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SEC's website.

Practice Tips

The main concern raised by the Section 16 amendments is timely filing of reports. Although the individual insider is legally responsible for fulfilling the Section 16 reporting requirements,[124] public companies must report any late filings by their insiders in the proxy statement delivered in connection with the annual meeting of shareholders.[125] To avoid the negative stigma attached to disclosing late filings, public companies have a vested interest in ensuring that their insiders are reporting transactions on a timely basis.

In part to ensure timely reporting, most public companies include provisions in their insider trading policies requiring pre-clearance of transactions in company securities with designated compliance officers. This requirement also serves as a check on potential insider trading violations. Sample XI-1 is a sample insider trading policy containing pre-clearance and Section 16 compliance procedures.

Another widely-used method of ensuring compliance is to obtain powers-of-attorney from insiders required to report under Section 16. The Section 16 rules permit filing of reports by power-of-attorney, which must either be already on file with the SEC, accompany the filing or be filed as soon as practicable after the filing.[126] The power-of-attorney is generally granted to several individuals, often including a legal officer of the company or outside securities counsel, to provide flexibility in the event of absence at the time filing is required.

The electronic filing requirement means that each individual insider must have access codes to the SEC filing system in order to file. These filing codes should be obtained sufficiently in advance of the initial required filing date to ensure timely filing.

Due to the tightened deadlines and the need to avoid late-reporting disclosure, many companies have provided insiders with increased assistance in filing Section 16 reports, including developing or acquiring software systems that enable insiders to file remotely at any time. Certain financial printers provide these filing systems. These systems are generally more user-friendly than the direct SEC filing system, and decrease the time needed to complete a filing – an important consideration under the new rules. Insiders should be well-trained on these systems prior to their use to avoid mistakes and late filings. In addition, practitioners are cautioned that Section 16 forms are complex and in many cases require relatively sophisticated knowledge to complete correctly. Insiders filing on their own can often make mistakes, which could result in liability for the insider and/or late filings reported by the company. Therefore, legal counsel review of reports prior to their filings is highly recommended.

[124] Exchange Act Section 16(a)(1); Exchange Act Rule 16a-2.
[125] See Exchange Act Schedule 14A, Item 7(b) and Regulation S-K, Item 405.
[126] *See* Section 16 Electronic Reporting Frequently Asked Questions (revised August 14, 2003), at Question 5.

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XII. Prohibition on Loans to Directors and Officers

Effective July 30, 2002, section 402(k) of SOX prohibits public companies from making most loans to executive officers and directors. The prohibition extends to any "issuer" as defined in Section 2 of SOX. Generally, an "issuer" is any company that has filed a registration statement (which has not been withdrawn).

The prohibition extends to any "director or executive officer (or any equivalent thereof) of [the] issuer." Although the SEC has not issued guidance on the scope of the term "executive officer", many commentators rely on the definition in Rule 3b-7 of the Exchange Act. Under this definition, an executive officer includes the issuer's president, any vice president in charge of a principal business unit, division or function, or any other person who performs similar policy making functions (including executive officers of subsidiaries if they perform such policy making functions for the issuer). The SOX 402 prohibition doesn't apply to a loan outstanding as of July 30, 2002, provided that there is no material modification or renewal of such loan. However, many commentators take the view that loans made on or after July 30, 2002 to individuals who later become directors or executive officers are prohibited.

Under Section 402, an issuer may not "extend or maintain credit," "arrange for the extension of credit", or "renew an extension of credit", in the form of a "personal loan." None of these terms is defined in SOX, and the SEC hasn't issued any guidance. Courts haven't addressed the issue either. As a result, a great deal of uncertainty exists as to how Section 402 will be applied to some of the specific situations described below:

Split Dollar Life Insurance. The split-dollar life insurance policy is a technique that was frequently used as one piece of the compensation plan for highly paid executives. Under typical **split-dollar** life insurance arrangements, a company pays the premiums on the insurance, but the death benefit is **split** between the company and the executive whose life is insured (and who is designated as the owner of the policy), with the company's portion of the death benefit generally intended to equal the aggregate amount of premiums that the company paid over the life of the policy. These policies could be considered loans (especially if the executive is designated as the owner of the policy) because the company, which pays the premiums on the policies, is eventually reimbursed. Some commentators question whether or not the provisions of Section 402 would apply to split-dollar arrangements in place on June 30, 2002, because of the exclusion of the application of Section 402 to loans existing on that date. However, others believe that the continuing payment of premiums could be viewed as a new extension of credit, because the amount of the loan is being increased. There have been some recent tax law changes that make split-dollar arrangements less attractive from a tax perspective as well. Given the lack of guidance, issuers are well advised to take the conservative approach and avoid the potential penalties that could come with split-dollar arrangements.

Cashless option exercises. Many companies have programs that allow option holders to exercise their options without having to come out of pocket with the cash necessary to exercise the options, by using the built in value in the options. This is known as a "cashless exercise". Frequently companies will have an arrangement with a broker under which the broker advances the exercise price on behalf of the option

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holder to the company against the option holder's pledge of the proceeds from the stock to be sold. Alternatively, the company may defer payment of the exercise price until the broker receives the proceeds of the sale of the stock underlying the option. The company simultaneously agrees to issue the stock underlying the options directly to the broker, allowing the broker to effect the sale transaction immediately upon receipt of the option exercise notice. In either circumstance, the company could be seen to be making a personal loan, either through "arranging" for credit through the broker or by forgoing the immediate payment of the option exercise price. Either arrangement can be easily viewed as violative of Section 402, and companies should carefully review any cashless exercise plans that they have in place to determine if officers and directors should be excluded.

Advances of Indemnification Expenses. Many commentators take the view that indemnification expenses are not loans because they aren't personal, but rather are a purely business item that arises out of services rendered to the company. Further, in a number of instances repayment is not required, and in those circumstances where repayment is required, sufficient contingencies ensure that the repayment is not certain to occur. Further, indemnification rights arise under state law, and there is nothing in SOX that suggests that it is intended to override state law on this point.

Credit Cards/Travel/Relocation payments. The use of credit cards and the advancement/payment of travel expenses by an company for purely business purposes should not run afoul of the prohibition on loans, because they are primarily for a business (and not personal) purpose. The company should adopt a policy with respect to travel expense advance/reimbursement that the payments must be reasonable in relation to the to required travel, that any unused advance be reimbursed and that the executive must provide documentation supporting the advances/reimbursement sought. When business and personal travel are mixed, the executive should be required to promptly reimburse the company for any personal expenses paid by the company. Similar policies should be adopted with respect to the use of company credit cards by executives. Ancillary personal items charged to a company credit card should be promptly reimbursed. Relocation advances or reimbursement should be treated the same way, provided that they are for a business purpose.

In-house counsel must be very careful when dealing with any arrangements that could be considered personal loans, that are not primarily for a business purpose. As the example with split-dollar life insurance shows, even those arrangements that at first look appear nothing like a traditional loan may violate this SOX provision. Changing circumstances may create unintentional violations-loans made before a company goes public, or to a person who is not a director or officer at the time the loan is made, must be carefully examined, and likely unwound or paid off, as the facts change over time. Public companies seeking to acquire other entities, where a person at the target is to become a director or officer, must examine all outstanding arrangements to determine if any must be terminated prior to closing.

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XIII. *Pension Fund Blackouts*

A. Overview

Concerns emanating from the Enron scandal about the ability of directors and officers to trade in company stock during periods in which trading was suspended under employee benefit plans led Congress to take action in SOX.[127] SOX Section 306(a) generally prohibits trading by insiders in company stock during benefit plan blackout periods, and subsequent SEC and Department of Labor rules have clarified this general proscription.[128]

B. Prohibition on Trades during Blackout Periods

1. Coverage

Acting pursuant to Congress' direction in Section 306(a), the SEC passed Regulation BTR,[129] which prohibits directors and executive officers of public companies from trading in any company equity security during a benefit plan "blackout period."[130] A blackout period is any period of three or more consecutive business days in which more than 50% of participants in all covered benefit plans of a company are prevented from acquiring, selling or otherwise transferring equity securities or interests in a covered plan.[131] The benefits plans covered by Rule BTR are termed "individual account plans" -- plans that permit investments in the company's equity securities and provide an individual account for each participant based solely on contributions by that participant.[132]

The trading prohibition applies only to equity securities acquired by the director or executive officer in connection with his or her service or employment as a director or executive officer.[133] Securities acquired by an insider by other means, including public market acquisitions using the insider's own funds, are not subject to the rules. The prohibition extends both to equity and derivative securities, and therefore covers options and other securities convertible into, and other rights to acquire, equity securities.[134]

2. Exceptions

SOX provided two specific exceptions to the "blackout period" definition:

- regularly scheduled blackout periods under plans that are timely disclosed to participants; and

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[127] *See, e.g., New SEC Rules Seek to Prevent Another Enron; Workers Will No Longer Face a Sales Blackout While Executives Are Able to Dump Shares*, Phila. Inquirer, January 16, 2003, at C1.
[128] *See* SOX Section 306(a) and SEC Release No. 33-34-47225 (January 22, 2003); *see also* SOX Section 306(b) and 29 C.F.R. § 2520.101-3 et seq. relating to changes in ERISA and Department of Labor rules.
[129] Regulation BTR, C.F.R. Part 245, §245.100 et seq.
[130] Id., at Rule 101.
[131] Id., at Rule 100(b).
[132] Id., at Rule 100(j).
[133] Id., at Rule 100(a).
[134] Id., at Rule 100(d)– (f).

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- blackout periods relating to termination of plan participation in connection with mergers or other similar corporate transactions involving the company sponsoring the plan.[135]

In addition, the SEC included in Regulation BTR several types of transactions exempt from the trading prohibition, including:[136]

- acquisitions under dividend reinvestment plans;
- transactions under a 10b5-1 plan in place prior to the blackout period;[137]
- "non-discretionary" transactions under certain benefit plans;
- gifts or transfers by will or laws of descent or distribution;
- transfers pursuant to domestic relations orders; and
- transactions occurring by operation of law pursuant to a merger or similar corporate transaction.

C. Department of Labor Advance Notice Rule

Under SOX Section 306(b), ERISA was amended to require plan administrators of "individual account plans"[138] to provide plan participants with at least thirty days advance notice of any periods greater than three consecutive business days in which participants are prevented from directing or diversifying assets or obtaining loans or distributions. The Department of Labor (DOL) subsequently issued rules clarifying the requirement.[139]

The definition of blackout period under the DOL rules is broader than the definition contained in Regulation BTR, and covers suspension of activity in plans that do not permit investment in equity securities.[140] The notice must be given at least thirty, but not more than sixty days, in advance of the last day before the suspension of plan activity.[141] The notice must contain the reasons for the blackout, a description of the plan activities that will be suspended or otherwise limited and the length of the blackout.[142] The length may be described in reference to either the expected beginning and ending dates of the blackout or the calendar week when the blackout is expected to begin and end.[143] The DOL has issued a model notice, which is included in Sample XIII-1.[144]

D. Notice to Insiders and SEC

Regulation BTR requires that companies send a notice of a blackout period to directors and executive officers.[145] The content of the notice is substantively similar to the notice to plan participants required under the DOL rules discussed above,[146] and must be delivered to directors and executive officers within

[135] Id., at Rule 102
[136] *See* Id., at Rule 101(c).
[137] *See supra*, Section XI, at n.6 for a brief description of 10b5-1 plans.
[138] *See supra*, at text accompanying n. 6.
[139] 29 C.F.R. § 2520.101-3 et seq.
[140] *See* Id., at §101-3(d)
[141] Id., at §101-3(b)(2)
[142] Id., at §101-3(b)(1)(iii)
[143] Id.
[144] *See also* Id., at §101-3(e)(2).
[145] Regulation BTR, *supra* n. 3, at Rule 104(a).
[146] *See* Id., at Rule 104(b)(2).

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five business days of the date it receives the DOL required notice.[147] If the company does not receive the DOL notice, it must nonetheless provide the required notice to directors and executive officers at least 15 calendar days before the actual or expected start date of the blackout.[148] If there is a later change in the blackout period dates, the company is required to send an updated notice to directors and executive officers as soon as reasonably practicable.[149]

In addition to the notice to directors and executive officers, companies are required to notify the SEC of the blackout period through the filing of a Form 8-K.[150] The Form 8-K must contain the same notice provided to the directors and executive officers, and must be filed within four business days of the company's receipt of the DOL notice.[151] If the company has not received the DOL notice in time to meet the initial five business day requirement to notify directors and executive officers, it must then file the Form 8-K the same business day it provides notice to directors and executive officers.[152] Any updated notice regarding timing of the blackout period triggers a requirement to file an additional Form 8-K containing the updated information.[153]

E. Remedies

SOX Section 306(a) provides for recovery of profits realized by a director or executive officer for violations of the blackout period trading restriction.[154] The right of recovery is automatic, and intent or scienter are not defenses to violations.[155] The right initially inures to the company; if the company fails to bring an action against the insider within sixty days of a request by an owner of equity securities of the company, the equity owner may bring the action.[156]

The profit recoverable is generally determined by comparing the difference between the amount paid or received for the security on the date of the blackout period transaction and the average market price of the equity security over the first three trading days after the blackout period ends.[157] The profit recovery rules also contain a catch-all provision stating that in any event recovery should be consistent with identifying gain realized or loss avoided.[158]

Violations of the blackout period trading rules are also subject to civil enforcement actions by the SEC.[159]

Practice Tips

[147] Id., at Rule 104(b)(2)(i)(A).
[148] Id., at Rule 104(b)(2)(i)(B).
[149] Id., at Rule 104(b)(2)(iii).
[150] Id., at Rule 104(a).
[151] Id., at Rule 104(b)(3)(i); Form 8-K, Item 5.04(a) Note that the Form 8-K must be filed one business day earlier than the notice is required to be delivered to directors and executive officers. Practically, most companies send the notice and file the Form 8-K on the same business day.
[152] Form 8-K, Item 5.04(a).
[153] Id., at Item 5.04(b).
[154] SOX Section 306(a); Regulation BTR, Rule 103(a).
[155] Id.
[156] Id., at Rule 103(b).
[157] Id., at Rule 103((c)(1).
[158] Id., at Rule 103(c)(2).
[159] *See* SEC Release No. 34-47225, at text accompanying n. 130.

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> *Timing issues and related coordination between a public company's human resources department (which are typically responsible for benefit plan matters) and the company's SEC disclosure personnel are the most important considerations in developing effective procedures for complying with the blackout period rules. Procedures should require that human resource personnel give advance notice, if possible, to SEC disclosure personnel of an expected benefit plan blackout period, or, at the least, simultaneously deliver the DOL notice to the SEC disclosure personnel. Special consideration may be given to the blackout period Form 8-K requirements in designing the company's written disclosure controls and procedures.*[160] *In addition, companies should consider including a section on blackout period trading restrictions in their insider trading policies to attune insiders to the rules and reinforce the prohibition.*
>
> *To avoid having to deliver additional notices to directors and officers and file additional Form 8-Ks for changes in blackout period dates, it is recommended that companies choose the "calendar week" rather than the "exact date" option when stating the start and end dates for the blackout period.*[161]

Sample DOL and director and officer notices is provided in Sample XIII-1.

[160] *See supra.,* Section VII.B for a discussion of Disclosure Controls and Procedures and related written policies.
[161] *See supra*, text accompanying n. 17.

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XIV. Employee Whistleblower Protection

A. Overview

SOX provides protection for "whistleblowers" (i.e. those persons who register complaints or concerns about their employers' suspected violations of law). These protections include prohibiting discrimination against those employees who complain about or assist in investigations, prohibiting retaliation against those employees and criminal and civil penalties for those who violate these prohibitions. In general, the whistleblower protections apply only to employees of public companies. However, at least one judge has ruled that these protections will extend to employees of subsidiaries even if the subsidiary itself is not publicly traded.

The whistleblower protection extends to public company employees who lawfully provide information or assist in the investigation regarding conduct that the employee reasonably believes constitutes a violation of:

- A rule or regulation of the SEC.
- Federal criminal provisions relating to securities, bank, mail or wire fraud.
- Any federal law relating to fraud against shareholders.

An employee is protected if the employee reports the information to, or the investigation is conducted by:

- A federal regulatory or law enforcement agency.
- Any member or committee of Congress.
- Any person with supervisory authority over the employee.
- Any other person who has "the authority to investigate, discover, or terminate the misconduct."

B. Civil Liability

SOX Section 806 provides for civil liability where a whistleblower/employee is retaliated against for raising complaints of the type described above. This private cause of action applies only to employees of publicly traded companies and is intended to protect employees who "provide information, cause information to be provided or otherwise assist in an investigation regarding any conduct which the employee reasonably believes constitutes a violation of Sections 1341, 1343, 1344 or 1348, any rule or regulation of the Securities and Exchange Commission or any provision of any federal law relating to fraud against shareholders." Employees are given a broad range of protections. The definition of retaliatory conduct includes "to discharge, demote, suspend, threaten, harass or in any other manner discriminate against an employee in the terms and conditions of employment." Those employees who bring a successful claim under Section 806 are entitled to "all relief necessary to make the employee whole" including reinstatement with no loss or seniority status, back pay with interest and "special damages" such as litigation cost, expert witness cost and reasonable attorneys' fees.

C. Criminal Liability

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Section 1107 creates criminal penalties for both public and private employers for retaliating or otherwise interfering with the lawful employment or livelihood of any person who provides to a law enforcement officer truthful information relating to the commission or possible commission of any federal offense. Criminal penalties include fines and imprisonment for up to ten years. This provision is particularly concerning because of the broad scope it applies to "any action harmful to any person" and disclosures regarding "any federal offense".

D. In-house Counsel Role

Pre-SOX whistleblower litigation frequently seemed to arise from workplaces in which there was not a clear and enforced policy prohibiting retaliation against employees who complain about suspected violations of law. Now, SOX requires the audit committees of public companies' boards of directors to establish procedures for receiving certain whistleblower complaints. No previous federal law mandated such procedures. Thus, the SOX requirement actually may help many employers by requiring them to develop, implement and enforce a non-retaliation policy.

SOX does not mandate the specific content of a whistleblower policy. Nonetheless, the likely content of such a policy may be inferred from the statute and from employers' prior experiences with complaint, grievance and alternative dispute resolution policies.

A "no retaliation" policy must be written in clear, simple language, informing employees that the company will not tolerate harassment, retaliation or any type of discrimination or adverse action against an employee who makes a good-faith complaint about suspected company violations of law. The policy should identify the persons (by job title rather than by name if personnel changes are likely) who are to receive complaints of whistleblower retaliation. To ensure that whistleblowers are not deterred by gender, status, or unavailability of one individual, the list of persons who are to receive such complaints should include men and women in a variety of levels of management across various departments. The policy should state that complaints of alleged retaliation will be promptly addressed and, to the extent permitted by law and consistent with an effective investigation, be kept confidential.

An employer cannot simply announce that it has enacted a "whistleblower retaliation" policy. The policy must be disseminated to employees (i.e., added to the employee handbook and given to employees at the time of hire and, perhaps, annually thereafter). The policy should be the subject of supervisor training to ensure that supervisors realize the significance of the policy, the consequences of whistleblower retaliation, and so that the company can use its training program as evidence of its good faith in any whistleblower litigation.

E. Investigation of Whistleblower Complaints

Whistleblower complaints must be addressed in a consistent, thoughtful and rapid manner. Although some complaints may be quickly resolved because they involve undisputed facts or clearly inconsequential matters (e.g., personality conflicts, not possible violations of law), others will require careful investigation. There typically are five strategic steps in such investigations:

- First, the company must select an investigator or investigative team. The best individuals are those who are personable and methodical, who have excellent interviewing and listening skills and who have received training in investigative techniques. Although an investigator should have knowledge of the company's policies, practices and "culture," it is not always

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necessary to have knowledge of the subject matter of the complaint or of the whistleblower's department. Frequently, there is value to having a relative "stranger," obviously with no self-interest in the outcome, conduct an investigation.

- Second, the investigator should review pertinent documents (including any written complaints of retaliation, applicable company policies and records, etc.). The nature and number of documents to be reviewed will be dictated by the complaint of retaliation.
- Third, the investigator should interview the whistleblower and likely fact witnesses. The content of the interviews largely will be determined by the nature of the complaint being investigated, but generally should include (a) a reminder that retaliation against persons for participating in the interviews is strictly prohibited and must be reported, (b) a statement that the identity of the informants and the confidentiality of their information will be maintained to the extent possible but cannot be guaranteed (e.g., others being interviewed may deduce who has been interviewed and what was said; certain information may have to be given to the company's legal department and, perhaps, to the government), and (c) an assurance that the witness will not be subject to discrimination or retaliation for participating in the investigation. The interviewer should use open-ended questions; a question as simple as "is there anything more I should know?" often gets surprising and useful answers. Interviews should not be audio-taped without the prior express consent of all persons present during the interviews (and their consents should be repeated, on the audio, after taping comments).
  - Most investigators take notes. It is critical that such papers be kept in special files, separate and apart from other company documents (including personnel files); obviously, the investigative materials must be locked-up to avoid employee snooping and tampering.
  - It is important to carefully consider the creation and retention of documents used during investigations because such papers may have to be furnished to an investigating agency or may become "evidence" if there is litigation. It is important to decide, early in the investigation, whether the company will attempt to protect the investigative files from future disclosure. Certain legal "privileges" may allow the company to refuse to produce those papers under certain circumstances, but "privileges" are technical concepts requiring the advice of legal counsel. Similarly, legal counsel should be consulted about the destruction of records to avoid future claims of obstruction of justice.
- Fourth, many investigations conclude with the preparation of a report summarizing the investigator's findings and, possibly, recommendations. However, the company should consider – before investigations begin – whether it is necessary or useful to prepare a written summary that may have to be disclosed to outsiders. If a report is prepared, it should identify the persons and the documents reviewed and contain an assessment of the evidence. Reports must not contain speculations about what might have occurred, comments about the alleged wrongdoer's propensities or generalized characterizations of events. Further, it is important to avoid making legal conclusions, e.g., it is better to say "John acted in an inappropriate manner" than "John sexually harassed his co-worker in violation of various federal and state laws." It is best simply to identify John's behavior. "John said...., and then made the following gesture…".
- Finally, the company must act on what the investigator has found and, if it appears that there has been discrimination against the whistleblower, the wrongdoers should be disciplined consistent with the severity of their misconduct. Regardless of the investigation's

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outcome, the whistleblower should be told, in general terms (to avoid revealing confidential information), about the investigation and its outcome.

F. Common Whistleblower Problems

A currently employed whistleblower may be a real problem for the employer because proof of "whistleblower" retaliation necessarily is based on the sequence of events: the whistle blowing occurred and then the employee suffered adverse employment action. Thus, once the whistle has been blown, the company must be able to demonstrate that any future adverse action against the whistleblower, including changes in pay, benefits, status, primary job duties, shift, etc., are justified by evidence that the whistleblower is being treated just as similarly situated employees who did not make complaints.

Whistleblowers sometimes are reluctant to pursue a retaliation complaint; it is not uncommon for human resources personnel who have been told about suspected retaliation also to hear "I don't want anything done about it." Such requests generally should be ignored: the whistleblower must be told that the complaint has put the company on notice of a potential problem and that any failure to investigate it could have legal consequences, that is, it might later be argued that the company ignored or approved of the retaliation by failing to investigate it.

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XV. Record Keeping Requirements

A. Overview

At its core, the objective of SOX is to improve the accountability and transparency of public companies. The implications of SOX for records management is expected to be significant enough that records management is no longer just an important business process, it is a critical compliance requirement.[162] For a more detailed discussion on the topic of records retention, the ACCA InfoPAK on records retention (February 2005) is an excellent source of material.

Most notably, SOX creates a new federal crime for destruction, mutilation or alteration of corporate records with the intent to impede or influence a government investigation or other official proceeding in "relation to or in contemplation of any such matter or case".[163] It is clear that in-house counsel will play a key role in the adoption, modification and enforcement of a practical and effective records retention policy. In the Arthur Andersen LLP case, an in-house lawyer at Andersen named Nancy Temple sent an e-mail to a risk management partner at the firm reminding him of the firm's policy on records retention and destruction and suggesting that he in turn remind the Enron engagement team at Andersen of the firm's policy. Many documents and pieces of correspondence were subsequently destroyed, and Andersen was prosecuted and convicted for obstruction of justice. While the criminal conviction of Andersen was recently overturned by a unanimous Supreme Court, the damage was done, and Andersen has disappeared from the corporate landscape. While some commentators believe that the Supreme Court may have been sending a subtle message about its view of SOX and future case that may arise under it, at this time, the better approach is clearly to adopt and enforce an effective records retention policy.

B. Section 802 and Auditor Requirements

Section 802 amends the obstruction of justice provisions of the U.S. Code to establish stiffer criminal penalties for altering or destroying documents. Unlike other provisions of SOX, these provisions are not limited to publicly traded companies. It applies to all records, including written documents and communications, email, voicemail and other any form of communication. Section 802 establishes revised and new obstruction of justice crimes that punish with up to 20 years in prison anyone who alters, destroys, mutilates, conceals, covers up, falsifies or makes a false entry in any record or document or other object, or attempts to do so with the intent to impede, obstruct or influence the investigation or administration of any matter within the jurisdiction of a federal department or agency or any bankruptcy case.[164]

Section 802 also imposes enhanced record keeping obligations on the auditors of public companies and registered investment companies, with respect to all audits completed after October 31, 2003. Specifically this section requires auditors to retain a broader scope of audit related information and to retain certain information for a period of seven years. The scope of information that must be retained by auditors under the new regulations is potentially very broad and includes records such as work

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[162] See mni/RIM White Paper: Records Management and the Sarbanes-Oxley Act (February 2005) www.omnirim.com

[163] See id.

[164] SOX at § 802 and § 1102, 18 U.S.C. § 1519.

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papers, any documents that form the basis of an audit or review, memoranda, correspondence, communications, documents and records (including electronic records) which are created, sent or received in connection with an audit or review and contain conclusions, opinions, analyses or financial date relating to such audit or review. SOX provides for criminal liability and imprisonment of up to 10 years for anyone who "knowingly and willfully" violates these requirements.[165] The SEC has provided some guidance as to what records are to be retained by auditors. The following criteria should be applied to determine whether or not specific information must be retained:

- The record was created, sent or received in connection with an audit or review, and
- It contains conclusions, opinions, analysis, or financial data related to the audit or review.

C. Section 1102

Section 1102 makes it a crime for any person to corruptly alter, destroy, mutilate, or conceal any document with the intent to impair the object's integrity or availability for use in an official proceeding or to otherwise obstruct, influence or impede any official proceeding; violators are liable for up to 20 years in prison and a fine.[166] Many commentators have adopted the view that this provision may apply to records retention programs that are unworkable in that they do not provide for easy access to or retrieval of records. Under SOX, the government can bring charges of obstruction of justice if a company destroys potentially relevant records even before a subpoena is issued.

D. Sentencing Guidelines regarding Obstruction

In Sections 805, 905 and 1104, SOX mandated the U.S. Sentencing Commission to review and amend, as appropriate, the federal sentencing guidelines and related policy statements concerning certain offenses by January 26, 2003 to ensure that the penalties and enhancements are adequate to deter and punish the conduct addressed by the Act.

The Federal Sentencing Guidelines set forth seven basis criteria as follows:

- Establish standards and procedures reasonably capable of reducing the chances of criminal conduct.
- Appointment of compliance officer(s) to oversee plans.
- Take due care not to delegate substantial discretionary authority to individuals who the organizations knows, or should know, are likely to engage in illegal conduct.
- Establish steps to effectively communicate the organization's compliance standards and procedures to all employees.
- Take reasonable steps to ensure compliance through monitoring and auditing.
- Employ consistent disciplinary mechanisms.
- When an offense is detected, take all reasonable steps to prevent future similar offenses, including modifying the compliance plan, when appropriate.

On April 8, 2004 the U.S. Sentencing Commission approved a series of amendments to the guidelines that toughen the seven criteria mentioned above. The amendments went into effect on November 1,

[165] SOX at § 802, 18 U.S.C. § 1520.
[166] See id at § 1102, 18 U.S.C. § 1519.

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2004 and elevate the seven requirements from commentary to guideline status.[167] Compliance training is strictly required, and delay in reporting an offense to authorities can disqualify an organization from eligibility for reduced sentences. Another change disqualifies an organization if a high level official in the organization participated in, condoned or was willfully ignorant of the offense. A controversial requirement is that a company must waive the attorney-client privilege if "such a waiver is necessary in order to provide timely and thorough disclosure of all pertinent information known to the organization."[168]

E. Practical Applications/Policy Formulation

In addition to the specific section cited above, record retention obligations will arise under other provisions of SOX. For example, the certifications required by Section 404 and the whistleblower policy obligation under 301 will likely give rise to additional recordkeeping requirements. No single document retention policy will suit the needs of every company. An effective document retention policy must be developed through the collaborative efforts of the company's management, administrative staff, legal counsel and auditors, with careful thought given to the role that each group will play in the development, application and enforcement of such a policy. It is important that the records retention policy provide for easy access to and retrieval of records, as a records retention policy that does not provide for easy access and retrieval of information may subject record managers or executives to potential fines or incarceration. Faulty recordkeeping will not constitute a defense to prosecution and the burden is on the company to provide the records sought. It is important to clearly document the records retention policy, as well as compliance with the policy, training given to foster adherence to the policy, changes to the policy, and applications of the policy.

An effective document retention policy should include, at a minimum, the following elements:

- Identification of documents that should be retained. Documents that are not necessary for the operation of the business, such as personal materials should not be retained. Material that is essential to the operation of the business, such as those items required by any regulatory/compliance obligations applicable to the company, financial records and personnel records should be retained.
- Establishment of a policy regarding electronic data, and an inventory of all hardware and software in use. Special care should be taken with respect to electronic documents stored in an employee's work or home computers. A document retention policy should include a notification to employees to keep all original documents on the company's servers and to delete all old copies of files from their work or home computers. In addition, the company must be aware of the information contained in metadata files and their accessibility.
- Specification of how long documents should or must be retained. The first level of consideration is the retention periods required by any regulations or compliance obligations applicable to the company. In the absence of any applicable regulations or compliance obligations, each company must use its judgment to decide how long to retain records, taking into account any pending investigations, applicable statutes of limitations, contractual obligations, and cost.
- Determination of the process for destroying documents, and the creation of a "destruction log".

[167] See USSG Ch. 8, B2.1.
[168] See id.

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- Establishing the circumstances under which document destruction should be suspended. The destruction of documents should cease when a lawsuit or government investigation is pending, threatened or even reasonably foreseeable.

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XVI. Private Company Implications

A. Applicability of SOX on Privately Held Companies

While most provisions of SOX apply to "issuers" or those serving as their advisors, such as their auditors and lawyers, there are several provisions of SOX that also apply to privately held companies.

1. New Penalties for Destruction or Falsification of Records in Federal Investigations and Bankruptcy

Section 802 of SOX provides for fines and up to 20 years of imprisonment to be imposed on any person who knowingly alters, destroys, mutilates, conceals, covers up, falsifies, or makes a false entry in any record, document, or tangible object with the intent to impede, obstruct, or influence the investigation or proper administration of any matter within the jurisdiction of any department or agency of the U.S. or any case filed under bankruptcy. Section 1102 of SOX provides for the same penalties for similar actions taken with the intent to impair the object's integrity or availability for use in an official proceeding. These provisions, applicable to private and public companies alike, call for effective and well-implemented record retention policies of all companies regardless of the size of their shareholder base.

2. Whistle-Blower Protection

Section 1107 of SOX provides for fines and up to 10 years or imprisonment to be imposed on any person who knowingly, with the intent to retaliate, takes any action harmful to any person, including interference with the lawful employment or livelihood of any person, for providing to a law enforcement officer any truthful information relating to the commission or possible commission of any federal offense. This provision gives even private companies a good reason to establish a hotline where employees can, on an anonymous basis, report suspicious conduct.

3. Extended Statute of Limitations for Securities Fraud

Section 804 of SOX extends the statue of limitations for securities fraud to two years after the discovery of the facts constituting the violation or five years after the violation. Since anti-fraud provisions of the federal securities laws apply to all securities offerings, regardless of the nature of the issuer, this provision affects private companies as much as it does public companies. Besides, Section 803 of SOX provides that debt resulting from any securities laws violation, common law fraud, deceit or manipulation in connection with the purchase or sale of any security, are no longer dischargeable in bankruptcy proceedings.

Practice Tip:

If you represent a public company that is about to acquire a private company which may have some exposure to securities fraud claims, make sure that the escrow account that you have set up to cover the contingent liabilities will last for at least 5 years from the date of the closing.

4. 30-day Notice Requirement for 401(k) Plan Blackout Periods

Section 306 of SOX provides that participants and beneficiaries under a 401(k) plan of any company

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must be furnished a written notice at least 30 days in advance of the blackout period. The written notice must be written in plain English, and include the reasons for the blackout period, an identification of the investments and other rights affected, the expected beginning date and length of the blackout period, and a statement that the participant or beneficiary should evaluate the appropriateness of their investment decisions in light of their inability to direct or diversify assets credited o their accounts during the blackout period. Generally speaking, a blackout period is defined as any period of more than three consecutive business days during which the ability of not fewer than 50% of the participants or beneficiaries under all plans maintained by the issuer to purchase, sell or otherwise acquire or transfer an interest in any equity of such issuer held in such plan is temporarily suspended by the issuer or by a fiduciary of the plan.

B. Applicability of SOX on Companies Going Public

SOX applies to companies that have filed registration statements with the SEC under the Securities Act of 1933 as well as companies required to file periodic reports under the Exchange Act of 1934. As soon as a company files a registration statement with the SEC registering its initial public offering, it has subjected itself to all the provisions of SOX, and will remain subject to SOX until it formally withdraws its registration statement or subsequently de-registers its securities under Section 12 of the Exchange Act.

Practice Tip:

> *If your company has extended loans to its officers in the past and such loan is still outstanding, don't forget to unwind or have your executive officer pay off their loans before you file the registration statement. Upon filing a registration statement with the SEC, the issuer will no longer be able to maintain, renew or extend loans or credits to its executive officer and directors (Section 402 of SOX). Private companies should extend loans to its insiders only if the loans specifically provide for immediate acceleration of the repayment obligation in the event that the private company is acquired by a public acquiring company and that the insider-borrower will become an executive officer or director of the public company post-closing.*

However, for the first twelve months after a company has gone public, there are certain limited exemptions available under the SEC rules. For instance, Section 301 of SOX requires that each member of the Audit Committee of an issuer be a member of the issuer's Board of Directors and be otherwise independent. Pursuant to Rule 10A-3(b)(iv) of the Exchange Act, for the first 90 days after the effective date of its IPO registration statement, the issuer is required to have only 1 member of its Audit Committee "independent;" and for the first year after the effective date of its IPO registration statement, the issuer is required to have only a majority of the members of its Audit Committee "independent."

Practice Tip:

> *Don't rely on the one year exemption. The search for independent Audit Committee candidates can only get tougher as time goes. Start the search early. Better yet, set up an Audit Committee with only independent directors before you file the registration statement with the SEC.*

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C. Other SOX Requirements that Have Become "Best Practices" among Privately Held Companies

Many of the corporate governance standards mandated by SOX, while technically not required to be met by privately held companies, have been embraced by well-run private companies, and companies with large institutional shareholder base in particular. After the Enron and Worldcom scandals, shareholders in general demand internal processes to be more transparent, and officers and directors to be more accountable. Former Chief Justice Norman Veasey of the Delaware Supreme Court once commented that in the future, the SOX standards would influence the court's assessment of whether or not fiduciary duties of care and loyalty were met by a company's officers and directors under Delaware laws.

Lending institutions and venture capital firms, prior to arranging or renewing a credit facility with, or making an investment in, a private company, respectively, are more inclined these days to scrutinize the sophistication and the independence of the board members, and to examine the internal controls and procedures of the borrower to make sure that the borrower's financial house is in order. Knowing that their CEOs and CFOs will be required to make certain certifications regarding the financial statements, the disclosure controls and the internal controls of their newly acquired private companies soon after an acquisition, public companies seeking acquisition targets are more inclined to pay a premium price for companies that already have well-established governance structure and policies in place. Therefore, private companies seeking merger partners can greatly enhance their attractiveness as an acquisition target by enhancing their corporate governance in accordance with SOX.

Set forth below is the Top 10 List of what private companies should consider adopting as "best practices":

1. Recruit independent members to join your board;
2. Recruit a financial expert to chair the Audit Committee;
3. Establish an Audit Committee with members that are prepared to ask tough questions;
4. Establish procedures for the Audit Committee to process complaints and submissions relating to questionable accounting or audit matters;
5 Prohibit insider loans;
6. Adopt a Code of Ethics and Business Conduct that applies to all directors, officers and employees of the company;
7. Adopt and adhere to a record retention policy;
8. Prohibit hiring outside auditor to render any non-audit related services;
9. Separate the roles of CEO and Chairman;
10. Develop disclosure control procedures; promote a corporate culture that is based on transparency, accountability and open communication.

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XVII. Additional Resources

ACC Resources

Green Eye Shades For Lawyers: A Toolkit, *ACC Docket* 23, no.3 (March 2005): 62-67 http://www.acca.com/protected/pubs/docket/mar05/toolkit.pdf

Danette Wineberg and Philip H. Rudolph, Corporate Responsibility: What Every Lawyer Should Know, ACC Docket 22, no. 5 (May 2004): 68-83 available at http://www.acca.com/protected/pubs/docket/may04/social.pdf

Peter Connor, If The Other Hat Fits- Wear it: A Guide To Effective Business Partnering, *ACC Docket*, 22, no. 9 (October 2004): 88-102 available at http://www.acca.com/protected/pubs/docket/oct04/partner.pdf

John K. Villa, Investigative Attorneys and the Reporting Obligations Under the SEC's Professional Conduct Rules, ACC Docket 22, no. 4 (April 2004): 133-137 available at http://www.acca.com/protected/pubs/docket/apr04/ethics.pdf

John K. Villa, Ethics & Privilege: Hidden Storms for Those in Safe Harbors: The SEC's Professional Conduct Rules and the Federal Preemption Doctrine, *ACC Docket* 22, no.2 (February 2004): 81-85 available at http://www.acca.com/protected/pubs/docket/feb04/ethics.pdf

Broc Romanek and Kenneth Winer, The New Sarbanes-Oxley Responsibility Standards, *ACCA Docket* 21, no. 5 (May 2003): 40-55, available at: http://www.acca.com/protected/pubs/docket/mj03/standard1.php

Richard F. Ober Jr. and Michael Parish, Maybe You Need a Lawyer: Does the Sarbanes-Oxley Act Make the SEC Your Client? *ACC Docket* 21, no. 4 (April 2003): 70-85, available at: http://www.acca.com/protected/pubs/docket/am03/client2.php

Joanne L. Bober, J. Alberto Gonzalez-Pita, et al. Closing Program: When "Jeopardy" Is No Longer a Game Show: Safeguarding Against Personal, Professional, & Fiduciary Liability, 2004 ACC Annual Meeting presentation, available at http://www.acca.com/am/04/cmpublic/closing.pdf

Lisa Change, Selena L. LaCroix, et al., Whistle While You Work: Ethical, Fiduciary, & Other Dilemmas Facing Over SOX'ed In-house Lawyers, 2004 ACC Annual Meeting presentation, available at http://www.acca.com/am/04/cm/308.pdf

Margaret M. Forman, Kerry A. Galvin, et al., Defining the Role of In-house Lawyers in Governance, 2004 ACC Annual Meeting presentation, available at http://www.acca.com/am/04/cm/711.pdf

Other Resources

- ABA Model Rules of Professional Conduct, at Rule 1.13: Organization as Client, *available at*: http://www.abanet.org/cpr/mrpc/new_rule1_13.pdf
- ABA Model Rules of Professional Conduct, at Rule 1.6: Confidentiality of Information, *available at*: http://www.abanet.org/cpr/mrpc/new_rule1_6.pdf

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XVIII. Sample Forms & Policies

Sample II-1: Excerpt of a sample D&O Questionnaire Director Independence

Directors and Nominees Only

[NASDAQ/AMEX]

The following questions elicit additional information from directors, nominees and prospective nominees to aid the Company in determining whether such persons satisfy the criteria for "independent" directors under applicable stock exchange standards.

Q. Have you been employed by the Company or by any parent or subsidiary of the Company in any capacity at any time during the current or last three years?

☐ Yes ☐ No

If you answered "yes", please provide details, including the dates and the capacities in which your served.

Q. Is any Family Member currently employed , or has any Family Member*, at any time during the past three years been employed by the Company, any parent or subsidiary of the Company as an **Executive Officer?**

☐ Yes ☐ No

Q. Have you , any of your Family Members*or any **Associate** accepted any payments in any capacity (including in exchange for goods and services, under consulting or personal services contracts with you , a Family Member or **Associate,** and political contributions to a campaign of yours or a family member) from the Company or any of its **Affiliates** in excess of $60,000 in any of the Company's last three fiscal years (or have or expect to receive such payments during the Company's current fiscal year), other than compensation for board or committee service, payments arising solely from investments in the Company's securities, compensation paid to a Family Member who is a non-executive employee of the Company or any of its **Affiliates**, benefits under a tax-qualified retirement plan, or non-discretionary

* "Family member" for purposes of this and the following questions means your spouse, parents, children and siblings, whether by blood, marriage or adoption, or anyone residing in your home.

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compensation (such as compensation that is predetermined in amount and is not conditioned upon continued service with the Company or its **Affiliates** or any other event)?

☐ Yes ☐ No

If you answered "yes", please provide details, including the dates and amounts of such payments and the purpose for which they were made.

Q. Are you, or is any Family Member of yours, a partner (other than a limited partner) in, or a controlling shareholder or an **Executive Officer** of, any organization (including charitable and non-profit organizations) to which the Company made, in the last three fiscal years, or expects to make in the current fiscal year, or from which the Company received in the last three fiscal years or expects to receive in the current fiscal year, payments (other than those arising solely from investments in the Company's securities or payments under non-discretionary charitable contribution matching programs) for property or services that exceed the greater of (a) $200,000 or (b) 5% of the Company's or such organization's (whichever entity received payments) consolidated gross revenues for that fiscal year?

☐ Yes ☐ No

If you answered "yes", please provide details, including the nature of the relationship, its duration, the amount of the payments involved and the dates of such payments.

Q. Are you, or is any Family Member of yours, employed as an **Executive Officer** of another entity where, at any time during the past three years, any **Executive Officer** of the Company served on the compensation committee (or board of directors or committee with comparable responsibilities, if the entity has no compensation committee)?

☐ Yes ☐ No

If you answered "yes", please identify below the name of the other entity, the dates of your service and the name of the Company's **Executive Officer** who serves or served on the other entity's compensation committee.

Q. Are you, or is any Family Member of yours, a current partner of the Company's outside auditor or at any time during the last three years, have you or any of your Family Members been a partner or employee of the Company's outside auditor, ______________________________ or any other auditor who worked on the Company's audit at any time during any of the last three years?

☐ Yes ☐ No

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If you answered "yes", did you or the Family Member work on the Company's audit engagement or any other matters for the Company while a partner or employee of such firm?

☐ Yes ☐ No

If you answered "yes", please provide details regarding the nature of your (including the name of the employer, title or position and dates of employment or affiliation) or your Immediate Family Member's affiliation or employment.

Q. Do you or any of your **Associates** have any other relationship with the Company, any of its **Affiliate**s or any other person or entity that could interfere with your ability to exercise independent judgment in carrying out your responsibilities as a director of the Company or your independence from Management of the Company?

☐ Yes ☐ No

If you answered "yes", please describe or specify or refer to the response to any other question in this questionnaire which describes such relationship:

[**NYSE**]

The following questions elicit additional information from directors, nominees and prospective nominees to aid the Company in determining whether such persons satisfy the criteria for "independent" directors under applicable SEC and stock exchange standards.

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Q. Do you or any of your **Family Members*** have any relationship with the Company, its parent(s) or any subsidiary of the Company (other than as interim Chairman or interim CEO, a director or shareholder), or are you or any of your **Family Members** a partner, shareholder or **Officer** of an organization that has a relationship (including commercial, industrial, banking, consulting, legal, accounting, charitable, and familial relationships), with the Company?

☐ Yes ☐ No

If you answered "yes", please describe the relevant relationship, including information as to the nature of the relationship, the amount involved in any transactions with the Company, the dates and frequency of any such transactions, etc.

Q. Are you now or have you been, at any time during the last three years, an employee of the Company, its parent(s) or any subsidiary of the Company (other than as interim Chairman or interim CEO).

☐ Yes ☐ No

If you answered "yes" please provide details including positions held and dates of service and termination.

Q. Have any of your Family Members been employed by the Company, or by its parent(s) or any subsidiary of the Company as an **Executive Officer**, (other than as an interim Chairman or interim CEO) at any time during the last three years?

☐ Yes ☐ No

If you answered "yes", and if you have not already provided pertinent details in response to another question in this Questionnaire, please indicate below the name(s) of the Family Member(s) and their employer(s), position(s) held, and dates of employment.

Q. At any time during the last three years, have you or any of your Family Members received more than $100,000 per year in direct compensation from the Company, its parent(s) or any subsidiary of the Company, other than (i) director and committee fees and pension or other forms of deferred compensation for prior service (provided such compensation is not

* For purposes of this Section, "family member" includes your spouse, parents, children, siblings, mothers and fathers-in-law, sons and daughters-in-law, brothers and sisters-in-law, and anyone (other than domestic employees) who shares your home. A person ceases to be an "family member" for this purpose upon legal separation, divorce, death or incapacity.

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contingent in any way on continued service), (ii) compensation received for prior service as an interim chairman or interim CEO or (iii) compensation received by an Family Member for service other than as an **Executive Officer**?

☐ Yes ☐ No

If you answered "yes", please identify below the individual's name, family relationship, if any, the amounts of compensation received, the services for which such compensation was received and the entity from which such compensation was received.

Q. At any time during the last three years, have you or any of your Family Members been employed by or affiliated with, in a professional capacity, the Company's or its parent's or any subsidiary's outside auditor, ____________________, or it's former outside auditor(s), ________________________?

☐ Yes ☐ No

If you answered "yes", please provide details regarding the nature of your or your Family Member's affiliation or employment (including the name of the employer, title or position, and dates of employment or affiliation). Please also indicate whether you or your Family Member worked on the Company's audit engagement or any other matters for the Company while an employee or otherwise affiliated with such firm.

Q. At any time during the last three years, have you or any of your Family Members been employed as an **Executive Officer** of another entity whose compensation committee (or board of directors or committee with comparable responsibilities, if the entity has no compensation committee) includes, or included during the time of your employment, any **Executive Officer** of the Company, its parent(s) or any subsidiary of the Company?

☐ Yes ☐ No

If you answered "yes", please identify below the name of the other entity, the dates of your or your Family Member's service and the name of the Company's **Executive Officer** who serves or served on the other entity's compensation committee.

Q. Are you an employee or **Executive Officer** or are any of your Family Members employed as an **Executive Officer** of another entity that makes payments to, or receives payments from,

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the Company, its parent or any subsidiary of the Company for property or services in an amount which, in any single fiscal year, exceeded the greater of $1 million, or 2% of such other entity's consolidated gross revenues at any time during the last three years?

☐ Yes ☐ No

If you answered "yes", please identify below the name of the other entity, the dates of your or your Family Member's employment, the property or services provided by the other entity to the Company, the amount of payments made to or received by the Company and the dates of receipt.

Identify any charitable contributions made by the Company to any charitable organization in which you serve as an **Executive Officer** if within the last three years such contributions in any single year exceeded the greater of $1 million or 2% of the charitable organization's consolidated gross revenues.

☐ Yes ☐ No

If you answered "yes", please identify the organization, your position, the amounts and dates of the contributions.

Q. Do you have any other relationship with the Company, its parent(s), any subsidiary or any **Affiliates** of the foregoing, or any other person or entity that you believe would interfere with your ability to exercise independent judgment in carrying out your responsibilities as a director of the Company?

☐ Yes ☐ No

If you answered "yes", please describe the relationship and the name of any other person or entity involved:

Sample III-1: Sample Audit Committee Charter

I. PURPOSE

The Audit Committee has been established by the Board of Directors to assist the Board in fulfilling its fiduciary responsibilities by overseeing the integrity of the Corporation's financial statements, the

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financial reporting processes, internal accounting and financial controls, the annual independent audit of the Corporation's financial statements, and other aspects of the financial management of the Corporation, including overseeing the establishment and maintenance of processes to assure compliance by the Corporation with all applicable laws, regulations and Corporation policy. In so doing, it is the responsibility of the Audit Committee to foster free and open means of communication between the directors, the independent auditors and the financial management of the Corporation.

II. COMPOSITION

The Committee shall consist of at least three independent members of the Board of Directors, who shall serve at the Board's pleasure. The Chair of the Committee shall be designated by the Board. The composition of the membership of the Committee shall comply with all applicable statutes and the rules and regulations of the Securities and Exchange Commission ("SEC") and the NASDAQ Stock Market. The members of the Committee must be able to read and understand fundamental financial statements.

III. MEETINGS

The committee will meet at least four times each year, or more frequently if deemed necessary, in its discretion. Special meetings may be called by the Chair. As part of its obligation to foster open communications, the Committee shall meet regularly with management and the independent auditors in separate executive sessions to discuss any matters that the Committee or each of these groups believe should be discussed privately.

IV. AUTHORITY

A. The Committee shall have the sole authority to appoint and dismiss the Corporation's independent auditors. The independent auditor shall report directly to the Committee.

B. The Committee shall have the sole authority to approve the amount of fees and other terms of any engagement by the Corporation of the independent auditors.

C. The Committee shall have the authority to retain special legal, accounting or other consultants to advise the Committee.

D. The Committee may request any director, officer or employee of the Corporation or the Corporation's outside counsel, or independent auditor or other consultant to attend a meeting of the Committee or to meet with any members of, or consultants to, the Committee.

E. The Committee may form and delegate authority to a subcommittee of the Committee, consisting of one or more members of the Committee, whenever it deems appropriate.

V. RESPONSIBILITIES AND DUTIES

In addition to any other responsibilities that may be assigned from time to time by the Board, the Audit Committee is responsible for the following matters:

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Independent Auditors

A. The Audit Committee shall be directly responsible for the appointment, compensation, retention and oversight of the work of any accounting firm engaged for the purpose of preparing or issuing an audit report or performing other audit, review or attest services for the Company (subject, if applicable, to shareholder ratification). Each such accounting firm shall report directly to the Audit Committee.
B. The Audit Committee shall pre-approve the audit services and non-audit services to be provided by the Company's independent auditor pursuant to pre-approval policies and procedures established by the Audit Committee. The Audit Committee may delegate its authority to pre-approve services to one or more Audit Committee members, provided that such designees present any such approvals to the full Audit Committee at the next Audit Committee meeting.
C. The Audit Committee shall review and approve the scope and staffing of the independent auditor's annual audit plan(s).
D. The Audit Committee shall evaluate the independent auditor's qualifications, performance and independence, and shall present its conclusions with respect to the independent auditor to the full Board on at least an annual basis. As part of such evaluation, at least annually, the Audit Committee shall:
    1. obtain and review a report or reports from the Company's independent auditor:
        a. describing the independent auditor's internal quality-control procedures;
        b. describing any material issues raised by (i) the most recent internal quality-control review, or peer review, of the auditing firm, or (ii) any inquiry or investigation by governmental or professional authorities, within the preceding five years, regarding one or more independent audits carried out by the auditing firm; and any steps taken to deal with any such issues;
        c. describing all relationships between the independent auditor and the Company consistent with Independence Standards Board Standard No. 1; and
        d. assuring that Section 10A of the Securities Exchange Act of 1934 has not been implicated;
    2. review and evaluate the lead partner of the independent auditor;
    3. consider whether the audit engagement team partners should be rotated more frequently than is required by law, so as to assure continuing auditor independence;
    4. consider whether the independent auditor should be rotated, so as to assure continuing auditor independence; and
    5. obtain the opinion of management and the internal auditors of the independent auditor's performance.
E. The Audit Committee shall establish policies for the Company's hiring of current or former employees of the independent auditor.

Internal Auditors

A. At least annually, the Audit Committee shall evaluate the performance, responsibilities, budget and staffing of the Company's internal audit function and review the internal audit plan. Such evaluation shall include a review of the responsibilities, budget and staffing of the Company's internal audit function with the independent auditor.
B. At least annually, the Audit Committee shall review the annual internal audit plan with the senior officer or officers responsible for the internal audit function of the Company. The

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review shall focus on the scope and effectiveness of internal audit activities and the department's capability to fulfill its objectives.

C. At least annually, the Audit Committee shall review significant findings by the internal audit staff and management's responses to such findings and instances of remedial action not being taken by management within appropriate timeframes in response to any such findings, if any.
D. At least annually, the Audit Committee shall evaluate the performance of the senior officer or officers responsible for the internal audit function of the Company, and make recommendations to the Board and management regarding the responsibilities, retention or termination of such officer or officers.
E. At least annually, the Audit Committee shall review the annual report from the internal auditors covering the internal auditor's review of the officers' and directors' travel and entertainment expenses.

Financial Statements; Disclosure and Other Risk Management and Compliance Matters

A. As appropriate, the Audit Committee shall review with management, the internal auditors and the independent auditor, in separate meetings if the Audit Committee deems it necessary:
   1. the annual audited financial statements, including the Company's disclosures under "Management's Discussion and Analysis of Financial Condition and Results of Operations", prior to the filing of the Company's Form 10-K;
   2. the quarterly financial statements, including the Company's disclosures under "Management's Discussion and Analysis of Financial Condition and Results of Operations", prior to the filing of the Company's Form 10-Q;
   3. any analyses or other written communications prepared by management and/or the independent auditor setting forth significant financial reporting issues and judgments made in connection with the preparation of the financial statements, including analyses of the effects of alternative GAAP methods on the financial statements;
   4. the critical accounting policies and practices of the Company;
   5. off-balance sheet transactions and structures;
   6. any major issues regarding accounting principles and financial statement presentations, including any significant changes in the Company's selection or application of accounting principles;
   7. estimates made by management having a material impact on the financial statements;
   8. significant variations in financial information between reporting periods; and
   9. the effect of regulatory and accounting initiatives or actions applicable to the Company (including any SEC investigations or proceedings).
B. The Audit Committee shall review, in conjunction with management, the Company's policies generally with respect to the Company's earnings press releases and with respect to financial information and earnings guidance provided to analysts and rating agencies, including in each case the type of information to be disclosed and type of presentation to be made and paying particular attention to the use of non-GAAP financial information.
C. The Chairman of the Audit Committee may review any of the Company's financial information and earnings guidance provided to analysts and ratings agencies and any of the Company's other financial disclosure, such as earnings press releases, as the Chairman deems appropriate.

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D. The Audit Committee shall, in conjunction with the CEO and CFO of the Company, review the Company's disclosure controls and procedures and internal control over financial reporting. The review of internal control over financial reporting shall include whether there are any significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to affect the Company's ability to record, process, summarize and report financial information and any fraud involving management or other employees with a significant role in internal control over financial reporting.
E. The Audit Committee shall review potential conflicts of interest involving directors and shall determine whether such director or directors may vote on any issue as to which there may be a conflict.
F. The Audit Committee shall review all related party transactions and determine whether such transactions are appropriate for the Company to undertake. If so, the Audit Committee is authorized to approve such transactions.
G. The Committee shall oversee compliance with the Company's Code of Conduct and report on such compliance to the Board. The Committee shall also review and consider any requests for waivers of the Company's Code of Conduct for the Company's directors, executive officers and other senior financial officers, and shall make a recommendation to the Board with respect to such request for a waiver.
H. The Audit Committee shall review annually management's plan for determining compliance with the Company Code of Conduct.
I. Review the Company's Information Security Plan.
J. Review significant cases of employee conflict of interest, misconduct, or fraud.
K. The Audit Committee shall review and discuss with the independent auditor any audit problems or difficulties and management's response thereto, including those matters required to be discussed with the Audit Committee by the auditor pursuant to Statement on Auditing Standards No. 61, as amended, such as:
    1. any restrictions on the scope of the independent auditor's activities or on access to requested information;
    2. any accounting adjustments that were noted or proposed by the auditor but were "passed" (as immaterial or otherwise);
    3. any communications between the audit team and the audit firm's national office regarding auditing or accounting issues presented by the engagement;
    4. any management or internal control letter issued, or proposed to be issued, by the auditor; and
    5. any significant disagreements between management and the independent auditor.
L. In connection with its oversight responsibilities, the Audit Committee shall be directly responsible for the resolution of disagreements between management and any auditor regarding the Company's financial reporting.
M. The Audit Committee shall review the Company's policies and practices with respect to risk assessment and risk management, including discussing with management the Company's major financial risk exposures and the steps that have been taken to monitor and control such exposures.
N. The Audit Committee shall establish procedures for:
    1. the receipt, retention and treatment of complaints received by the Company regarding accounting, internal accounting controls or auditing matters, and
    2. the confidential, anonymous submission by employees of the Company of concerns regarding questionable accounting or auditing matters.

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O. The Audit Committee shall review any complaints regarding accounting, internal accounting controls or auditing matters received pursuant to such procedures.
P. The Audit Committee shall prepare the Audit Committee report that the SEC rules require to be included in the Company's annual proxy statement.

Reporting to the Board

A. The Audit Committee shall report to the Board periodically. This report shall include a review of any issues that arise with respect to the quality or integrity of the Company's financial statements, the Company's compliance with legal or regulatory requirements, the independence and performance of the Company's independent auditor, the performance of the internal audit function and any other matters that the Audit Committee deems appropriate or is requested to be included by the Board.
B. At least annually, the Audit Committee shall evaluate its own performance and report to the Board on such evaluation.
C. The Audit Committee shall periodically review and assess the adequacy of this charter and recommend any proposed changes to the Board.

V. COMMITTEE RESOURCES

The Committee shall have the authority to obtain advice and seek assistance from internal and external legal, accounting and other advisors. The Committee shall determine the extent of funding necessary for the payment of compensation to any consultant retained to advise the Committee.

Sample IV-1: Sample Compensation Committee Charter

I. PURPOSE

The purpose of the Compensation Committee (the "Committee") of the Board of Directors (the "Board") of the Company is to, among other things, discharge the Board's responsibilities relating to the compensation of the Company's executives and to produce an annual report on executive compensation for inclusion in the Company's proxy statement, in accordance with the rules and regulations of the Securities and Exchange Commission (the "SEC").

II. COMPOSITION

The Committee will be composed solely of independent directors. The members of the Committee shall be appointed by the Board based upon nominations by the Company's Corporate Governance and Nominating Committee. The members of the Committee will serve at the discretion of the Board. The Committee shall designate one member of the Committee as its chairperson.

III. AUTHORITY

Except as restricted by law, the Company's Articles of Incorporation, or its Bylaws, and except for such activities as the Board of Directors may specifically reserve for consideration or approval by the Board, the Committee shall have, and may exercise, all authority that is vested in the Board with respect to the following matters and such other compensation related matters that may reasonably be considered or approved by the Committee:

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A. Review annually the overall compensation and fringe benefits policies and practices of the Company.

B. Except as specifically provided by this Charter, review and recommend to the Board the adoption of, or amendments to, stock option, stock-based incentive, or stock purchase plans of the Company.

C. Review and recommend to the Board the adoption of, or amendments to, the annual bonus or other incentive plans of the Company, including performance standards related thereto.

D. Grant options and awards under the stock option, bonus and other incentive plans.

E. Determine, in a closed session without the presence of the Chief Executive Officer (the "CEO"), on an annual basis, the CEO's annual compensation, including salary, bonus, incentive and equity compensation.

F. Determine, on an annual basis, the compensation for all other officers of the Company, including, base salary, bonuses, stock-based awards and other benefits.

G. Determine and approve any salary changes for all officers of the Company.

H. Except as provided for in this Charter, recommend for approval by the Board the adoption of, or amendments to, any retirement, profit sharing, savings, or deferred compensation plan.

I. Approve all employment agreements with executive officers and non-executive officers.

J. Recommend to the Board all changes in cash or stock-based compensation for directors.

K. Prepare an annual report on the Company's executive compensation policies and practices as may be required under proxy rules adopted by the SEC for publication in the Company's Proxy Statement or other reports to shareholders.

L. Review periodically with the CEO the succession plans relating to positions held by corporate officers and make recommendations to the Board with respect to the selection of individuals to occupy these positions.

The Committee shall have unrestricted access to Company personnel and documents and will be given the resources necessary to operate under this Charter. The Committee shall have the power to conduct or authorize investigations into any matters within the scope of this Charter.

IV. MEETINGS

The Committee shall meet at any time and from time to time, when and as determined in its discretion, but not less frequently than annually. The Committee may ask members of management

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or others to attend any meeting and provide pertinent information as necessary. The Committee shall prepare and render to the Board reports of its meetings, actions and recommendations.

V. ACTIONS OF THE COMPENSATION COMMITTEE

A majority of the Committee shall constitute a quorum, and the action of a majority of the members of the Committee present at any meeting at which a quorum is present, or acts unanimously adopted in writing without the holding of a meeting, shall be the acts of the Committee.

VI. REVIEW OF CHARTER

This Charter shall be reviewed by the Board at least annually.

Sample V-1: Sample Nominating/Corporate Governance Committee Charter

I. PURPOSE

The Corporate Governance and Nominating Committee of the Board of Directors assists the board in fulfilling its oversight responsibilities relating to the Company's corporate governance matters, including the development of corporate governance guidelines, periodic evaluation of the Board, its committees and individual directors, identification and selection of director nominees, oversight of the Company's policies and practices relating to ethical and compliance issues, and such other duties as directed by the Board.

II. COMPOSITION

The Committee shall consist of at least three (3) members of the Board, who shall serve at the Board's pleasure. All of the members of the Committee must meet the independence requirements listed in Rule 4200(a)(15) of the NASDAQ Stock Market, Inc. ("NASDAQ") and such other applicable requirements as may be adopted by NASDAQ or may be required under federal securities laws or regulations from time to time. Committee members and the Committee Chairperson shall be designated annually by the Board.

III. MEETINGS

The Committee shall meet at any time and from time to time, when and as determined in its discretion, but not less than twice a year. The Committee may ask members of management or others to attend all or a portion of any meeting and provide pertinent information as necessary. The Committee shall prepare and render to the Board reports of its meetings, actions and recommendations as the Committee determines to be appropriate or as requested by the Board.

IV. AUTHORITY

Corporate Governance Matters

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The Committee shall have the following responsibilities with respect to its oversight of corporate governance:

A. Regularly review issues and developments relating to corporate governance.

B. Develop and recommend to the Board a set of corporate governance principles for the Company or, as appropriate, changes to existing corporate governance principles of the Company.

C. Develop and conduct a performance appraisal system in order to review the performance of the Board and its committees.

D. Review Compensation Committee recommendations to the Board regarding matters concerning the directors' compensation.

E. When directed by the Board (and, if appropriate, in co-ordination with the Audit Committee), consider questions of possible conflicts of interest of Board members and of the Company's senior executives, and review and recommend to the Board for approval or disapproval all proposed related party transactions and other transactions involving possible conflicts of interest.

F. When directed by the Board, review the outside activities of a senior executive, when such activities may affect the Company or the ability of the executive to perform his job.

<u>Director Nomination Matters</u>

The Committee shall perform the following with respect to director nominations:

A. Establish, articulate and recommend to the Board qualifications, skills, and other desired background and selection criteria for members of the Board. Such criteria should include, among other things, integrity, independence, diversity and extent of experience, length of service, number of other board and committee memberships, leadership qualities and the ability to exercise sound judgment.

B. Identify individuals qualified to become Board members, consistent with criteria established or approved by the Board. This shall include the responsibility for reviewing Board candidates proposed by a shareholder of the Company.

C. In conjunction with Company's management, retain and terminate search firms to be used to identify director nominees.

D. Conduct appropriate and necessary inquiries into the backgrounds and qualifications of possible candidates.

E. Select and recommend to the Board director nominees each year for election at the annual meeting of shareholders and select and recommend to the Board candidates to fill director vacancies on an interim basis until the next annual meeting of shareholders. At the time of recommending director nominees or candidates to fill director vacancies on an interim basis

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to the Board, the Committee shall inform the Board of the criteria used in making its recommendations.

F. As part of the process of recommending nominees to the Board, take into account the requirement that the Audit Committee be composed of independent directors with financial literacy and at least one member who has accounting or related financial management expertise and who meets the definition of an "audit committee financial expert" under the rules of the SEC.

G. To the extent required, engage such other advisors (such as legal counsel, consultants, etc.) as the Committee deems necessary to effectuate it purposes.

The Committee shall have unrestricted access to Company personnel and documents and will be given the resources necessary to operate under this Charter. The Committee shall have the power to conduct or authorize investigations into any matters within the scope of this Charter.

V. ACTIONS OF THE COMMITTEE

A majority of the Committee shall constitute a quorum, and the action of a majority of the members of the Committee present at any meeting at which a quorum is present, or acts unanimously adopted in writing without the holding of a meeting, shall be the acts of the Committee. The Committee shall have the authority to delegate any of its responsibilities to subcommittees, management or third parties, as the Committee may deem appropriate in its sole discretion.

VI. REVIEW OF CHARTER

This Charter shall be reviewed by the Board at least annually.

Sample VII-1: Sample Disclosure Controls and Procedures Policy and Timelines

XYZ, INC.
DISCLOSURE CONTROLS AND PROCEDURES

Purpose

The Securities and Exchange Commission (the "Commission") rules require the CEO and CFO to certify, with respect to each quarterly and annual report (and amendments), that (1) they have reviewed the report, (2) based on his or her knowledge, the report is not misleading, (3) based on his or her knowledge, the financial statements and other financial information included in the report "fairly present" in all material respects the financial condition, results of operations and cash flows of the Company and (4) they are responsible for establishing and maintaining, and have performed certain specified tasks with respect to, the Company's "internal control over financial reporting " and "disclosure controls and procedures," including making disclosures to the Company's auditors and audit committee regarding all significant deficiencies and material weaknesses in the Company's internal control over financial reporting and presenting in the periodic

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report their conclusions about the effectiveness of the disclosure controls and procedures and any significant changes in internal control over financial reporting.

While the certification requirements do not currently apply to reports on Form 8-K or proxy materials, disclosure controls and procedures must be designed, maintained and evaluated to help ensure full and timely disclosure of all matters required to be disclosed by the Company in all reports filed with the Commission required by the Securities and Exchange Act of 1934 (the "Exchange Act"). Accordingly, the policies, controls and procedures set forth herein should be applied with equal diligence to all filings, submissions and public disclosures whether or not the Commission determines to adopt further express certification requirements.

The Disclosure Committee has established the following policies, controls and procedures to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Commission's rules and forms. The controls and procedures are designed to ensure that the information required to be disclosed by the Company is accumulated and communicated to the Company's management as appropriate to allow timely decisions regarding required disclosure. The controls and procedures are designed to provide reasonable assurance that they will meet their objectives.

Disclosure Committee

The Company shall have a standing Disclosure Committee to review and consider the materiality of information and determine disclosure obligations on a timely basis. The Disclosure Committee has the following responsibilities, among others:

Coordinate Review and Oversight of Exchange Act Filings

The Disclosure Committee shall coordinate the review and oversight of the Company's Exchange Act periodic reports with the CEO, CFO, independent accountants, legal counsel, internal auditors and the Audit Committee.

Receive Compliance Reports

The Disclosure Committee shall receive reports regarding compliance with the Company's other standing policies and procedures regarding securities law matters, including the Company's policies relating to compliance with Regulation FD and Section 16 of the Exchange Act and regarding insider trading (including pre-clearance procedures for trading in the Company's securities by directors, Section 16 officers and certain other employees).

Receive Audit Reports

The Disclosure Committee shall receive reports from the Company's financial and internal audit departments regarding changes in Commission reporting requirements and accounting standards to help ensure that all applicable disclosure, financial reporting and accounting rules are being fully complied with by the Company.

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Receive Disclosure Reports

Although the CEO and CFO retain ultimate responsibility for such matters, the Disclosure Committee shall also receive reports from the Company's financial and internal audit departments regarding compliance with all applicable Commission rules relating to disclosure controls and procedures and for reviewing whether the Company's internal control over financial reporting and reporting systems are sufficiently robust in gathering the necessary information to satisfy its public disclosure requirements as required by applicable securities laws and regulations and for monitoring the integrity of the information collected.

Review Auditor Reports Regarding Disclosure and Internal Controls

The Disclosure Committee shall review all material audit and other evaluations of the Company's internal control over financial reporting and related disclosure controls and procedures to help ensure that proactive measures are taken to rectify any weaknesses that have been identified in such controls and procedures.

Review Earnings Releases

The Disclosure Committee shall review all earnings releases and related questions and answers and investor presentations and scripts for earnings conference calls held in connection with the release of earnings or otherwise made publicly available in connection with earnings releases to help ensure that the releases and related materials fairly present the financial condition of the Company and its subsidiaries as of the dates to which they relate.

Monitor Investor Presentations

The Disclosure Committee shall monitor all other investor and industry presentations made by the Company or its personnel that contain material financial information not previously publicly disclosed.

The Disclosure Committee Charter shall set forth the Committee's composition and responsibilities, which shall include those set forth above.

Quarterly Evaluation of Disclosure Controls and Procedures

The CEO and CFO, together with the Disclosure Committee, shall evaluate the effectiveness of the Company's disclosure controls and procedures on a quarterly basis as of the end of that period. In particular, they shall review any issues that are raised regarding weaknesses in the disclosure and control systems or internal controls and financial reporting systems, and how they have been addressed. While the evaluation is of effectiveness overall, the CEO and CFO shall have the ability to make judgments that evaluations, particularly quarterly evaluations, should focus on developments since the most recent evaluation, areas of weakness or continuing concern or other aspects of disclosure controls and procedures that merit attention.

Continuous Monitoring of Reporting Requirements

The Company's financial reporting group, headed by the Company's Controller, (the "Financial Reporting Group"), shall be primarily responsible for the preparation and timely filing

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with the Commission of the Form 10-K and Form 10-Q reports ("Reports"), the Company's definitive annual shareholders meeting proxy statement, form of proxy, and any additional proxy solicitation materials (together, "Proxy Materials") and the Form 8-K reports. Changes in Commission reporting requirements and accounting standards shall be routinely monitored by the senior finance and audit staffs to help ensure that all applicable accounting and reporting requirements are reported correctly in all periodic filings and reports, with all material developments relating thereto being reported to the Disclosure Committee. The Financial Reporting Group and legal counsel shall monitor enacted and proposed changes in these regulations and in NASDAQ Stock Market ("NASDAQ") listing standards on an ongoing basis.

The Financial Reporting Group shall be responsible for the implementation of new or revised financial reporting and disclosure requirements as they relate to the Reports, Proxy Materials and Form 8-Ks, and for the dissemination of such new or revised requirements to the appropriate persons throughout the Company.

The Disclosure Committee shall, when appropriate, hold periodic meetings with representatives from the Company's centralized finance functions, including the Financial Reporting Group and the business unit vice presidents, and provide a forum to discuss accounting and disclosure matters.

Preparation of Commission Reports and Proxy Materials

Establish Reporting Timeline

The Financial Reporting Group shall establish and update a timeline for the preparation of each Report and Proxy Materials that the Company is required to file with the Commission.

Distribute Assignments and Memos

Prior to each quarter-end (March 31, June 30, September 30 and December 31), the Financial Reporting Group, in conjunction with legal counsel, shall prepare and distribute assignment sheets and/or other memoranda to employees of the Company responsible for the preparation or review of one or more portions of the Reports and Proxy Materials and their respective supporting schedules that outlines key dates and individual responsibilities for supporting documentation. The Financial Reporting Group shall revise the timetables going forward in view of accelerated filing deadlines under Commission rules.

Inquire with Management

The Disclosure Committee shall make inquiries of others within the Company, including business unit vice presidents, regarding any material business developments or trends and other potential disclosure matters.

Distribute Director & Officer Questionnaires

Director & Officer Questionnaires to directors and executive officers and prepare and distribute memoranda and worksheets to employees of the Company responsible for the preparation or review of one or more portions of the Proxy Materials that outlines key dates and individual responsibilities for supporting documentation. The form of the Director &

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Officer Questionnaire shall be reviewed annually by legal counsel for adequacy and compliance with any proxy rule and other disclosure changes since the preceding year.

Review Significant Transactions

The Company's internal audit function shall perform a quarterly review of significant transactions that may impact the consolidated financial statements and related disclosures contained in the Reports. The findings shall be reported to the Financial Reporting Group and the Disclosure Committee.

Gather Press Release and Form 8-K Statistics

For the period covered by the Form 10-K or Form 10-Q and through the filing date, the Financial Reporting Group shall review corporate press releases and perform a review to determine if any Form 8-Ks have been filed on behalf of the Company which would require disclosure in the Reports.

Nonrecurring Exhibits

The Financial Reporting Group shall solicit information from appropriate employees of the Company, including legal counsel, regarding possible nonrecurring exhibits to the Reports and Proxy Materials.

Prepare Draft

The Financial Reporting Group, with assistance from certain employees of the Company within management, accounting, and finance shall prepare specific sections of the Reports and Proxy Materials.

Maintain Supporting Documentation

The Financial Reporting Group shall maintain supporting documentation for each section of the Reports and Proxy Materials. Master logs or other documentation shall be maintained to confirm the Financial Reporting Group's receipt of supporting documentation prior to filing of the Reports and Proxy Materials with the Commission.

Reconcile with General Ledger

Each Form 10-K and 10-Q shall be reconciled to the consolidated general ledger. Workpapers shall be maintained to support each page and/or supplemental schedule of the Form 10-K or 10-Q and include the signatures of both the preparer and reviewer/approver of each workpaper.

Consider Commission Comments

The Financial Reporting Group and legal counsel shall review Commission comment letters, if any, on the Company's filings relating to accounting and disclosure matters and Proxy Disclosure matters and the Company's responses to the Commission prior to filing of the Reports and Proxy Materials to help ensure compliance with comments and undertakings.

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The Company shall seek to resolve outstanding Commission comments relating to accounting and disclosure matters prior to filing.

Review of Reports and Proxy Materials

Provide Workpapers to Accountant

A complete copy of the Form 10-K and 10-Q workpapers and other supporting documentation shall be provided on a timely basis to the Company's independent accountants for review prior to filing.

Review Draft

Prior to filing, drafts of the Reports and Proxy Materials shall be reviewed by the Company's independent accountants, internal auditors, appropriate corporate and business unit management personnel, the Disclosure Committee and legal counsel.

Drafts shall be circulated for review via either an attachment to an electronic mail ("email") message or in hard copy form. A cover memo or email message shall accompany the draft with an indication of when (date and time) comments or questions are to be provided. Comments shall generally, but not always, be requested to be provided in writing.

Review comments shall be typically solicited and received by a member of the Financial Reporting Group. Action shall be taken on review comments/questions in one of the following ways: reflecting the comment in a subsequent draft of the Report; responding to the reviewer either verbally or in writing; raising the comment/question to senior management for further review; or otherwise disposing of the comment if, in the judgment of the head of the Financial Reporting Group and/or the Disclosure Committee, no further action is considered necessary.

Disclosure Committee Must Communicate with Audit Committee

As necessary, the Disclosure Committee or members of such committee shall discuss among its members and when appropriate communicate with the Audit Committee, with respect to significant disclosure issues considered by the Disclosure Committee.

Perform Rules Check

Prior to filing, the Financial Reporting Group, the independent accountants, and legal counsel shall perform a "rules check" on the Report and Proxy Materials to verify that it "complies as to form" on its face with the technical requirements of the applicable securities laws and regulations pursuant to which it is being filed.

Board Review

The Company's Board of Directors (the "Board"), including the Audit Committee, shall review a draft of the "Financials" section of the Annual Report to Shareholders ("Annual Report") at or around the first quarter board meeting. The Financials section consists of selected consolidated financial data, management's discussion and analysis of financial

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condition and results of operations, reports from management and the independent accountants on the consolidated financial statements, consolidated financial statements, notes to consolidated financial statements and statistical information.

The Company's Board, including the Audit Committee and Compensation Committee, shall review a draft of the Proxy Materials during the first quarter board meeting.

At a meeting held near the end of the first quarter, the Audit Committee of the Board shall review a draft of the entire Annual Report and Proxy Materials prior to printing.

The Board shall review a draft of the body of the Form 10-K prior to filing. Together with a draft of the Form 10-K, the Company's directors shall be furnished with and asked to sign a power of attorney after they have reviewed the Form 10-K in accordance with the SEC's signature requirements. The manually signed powers of attorney shall be kept on file by the Financial Reporting Group in accordance with SEC regulations.

With respect to each 10-K and 10-Q, the Audit Committee of the Board shall review a draft of the Form 10-K or 10-Q with management and the outside auditors after all internal review procedures have been completed and prior to filing. The Audit Committee shall discuss with management the material issues which arose in connection with the preparation of the Report. In addition, the Audit Committee shall review the material issues that relate to the design and implementation of the Company's internal control over financial reporting and disclosure controls. In particular, the Audit Committee shall confirm with the CEO and CFO whether there are any deficiencies in the internal control over financial reporting or alleged fraud (whether material or not) involving management or other employees with significant roles in internal controls. The Audit Committee shall also discuss with the CEO and the CFO the certifications (referred to below) that they are providing and understand the procedures they undertook.

Accountant Reports

The Company's independent accountants shall provide a report addressed to the Audit Committee of the Company's Board regarding the quarterly reviews performed by the independent accountants, which includes review of the Form 10-Q and an SAS 71 letter. This report and letter shall be dated as of or within a few days prior to the filing of the Form 10-Q.

The Company's independent accountants shall provide a report addressed to the Company's Board regarding their review of the Form 10-K. This report shall be separate from the report of independent accountants resulting from their audit of the consolidated financial statements which is included in the Financials referred to above. The Form 10-K review report shall be dated as of or within a few days prior to the filing of the Form 10-K. The signed audit letter shall be received prior to the filing of the Form 10-K.

Disclosure Committee Review

As the last stage of review, the Reports and Proxy Materials shall be reviewed by the Disclosure Committee. The CEO and CFO together with the Disclosure Committee shall make appropriate inquiries (including with the internal and external auditors and legal

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counsel as appropriate in the view of the Disclosure Committee) into the quality and timeliness of the Company's controls and reporting systems. In particular, they shall review any issues that are raised regarding weaknesses in the disclosure and control systems or internal control over financial reporting, and how they have been addressed. They shall also understand any changes that have been made to the nature and scope of procedures relating to the internal control over financial reporting.

Certification

The Disclosure Committee shall provide subordinate certifications to the CEO and CFO regarding the Reports.

The Reports shall be certified by the CEO and the CFO in connection with the certification requirements established in 2002 under SEC Release No. 33-8124 and Section 906 of SOX.

In connection with the review by the Disclosure Committee and the CEO/CFO certifications referred to above, selected corporate and business unit management shall meet with the CEO and CFO (and with the other members of the Disclosure Committee if so desired), as requested by the CEO and CFO (or the Disclosure Committee as the case may be) to discuss the content of the filing and provide internal certifications or other affirmations tailored to the areas of responsibilities of the individuals making the certifications of the information contained in the filing in support of the CEO/CFO certifications, and reasonable disagreements between individuals providing internal certifications or affirmations are resolved (with appropriate documentation of such resolutions). The CEO and CFO, together with the Disclosure Committee, shall also confirm with the Company's internal auditors, independent accountants and legal counsel that none are aware of material misstatements or omissions in any Report prior to filing.

Filing of Reports and Proxy Materials

Submit Using Financial Printing Firm

An external financial printing firm ("financial printer") shall be engaged by the Company to convert the draft Reports and Proxy Materials (including all exhibits being filed) into a format suitable for submission to the SEC via the SEC's EDGAR filing system.

After conversion of the draft Reports and Proxy Materials and exhibits into EDGAR suitable format, the EDGAR draft shall be proofread back to the hard copy draft of the Reports and Proxy Materials and exhibits by the Financial Reporting Group. Any subsequent changes shall also be converted into Edgar format and proofread.

The financial printer shall provide the Financial Reporting Group with an "EDGAR submission proof" representing the final draft version of the EDGAR filing prior to submission to the SEC. After approval is received from the head of the Financial Reporting Group, the financial printer shall file the Reports and Proxy Materials electronically via EDGAR with the SEC on the Company's behalf.

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Subsequent to filing via EDGAR, a confirmation from the SEC shall be sent via email directly to the Financial Reporting Group and retained by the Financial Reporting Group as a component of the supporting documentation of the Reports.

Access on Website

Subsequent to filing, the Financial Reporting Group shall initiate a process with the Company's [Information Systems] group to create a hypertext link to the Reports and Proxy Materials via the Company's Internet web site.

Retain Signatures

Manually-signed signature pages for the Reports and Proxy Materials and for the required CEO/CFO certifications shall be maintained by the Financial Reporting Group for at least five years in accordance with SEC regulations.

Preparation, Review and Filing of Form 8-Ks

The Financial Reporting Group shall be responsible for the preparation, review and filing of the report of Form 8-K.

The filing of a Form 8-K generally follows the process outlined in Section I, II and III above. However, some or all of these steps may be changed by the Financial Reporting Group or the Disclosure Committee, depending upon the nature of the event.

If applicable, workpapers shall be prepared and provided to the Company's independent accountants on a timely basis for review prior to filing.

Drafts of Form 8-K filings shall be reviewed as necessary by the Company's independent accountants, Disclosure Committee, CEO, CFO, and legal counsel. Additional reviews by the Board shall be dependent upon the nature of the disclosure contained in the filing.

The Company's Form 8-K filings shall be signed by the CFO. Manual signature pages shall be maintained by the Financial Reporting Group in accordance with SEC regulations.

Maintenance of Records and Catalog

The Company shall maintain an accurate record indicating how each Report, Proxy Materials and Form 8-K was prepared as part of the formal records of the Company. Such information shall be available for review to the Audit Committee and the Disclosure Committee.

The Company shall appropriately document the resolution of any disagreements between or among the members of the Disclosure Committee, the Audit Committee, internal auditors, external auditors, management and others that arise in connection with the certification and review procedures.

The Finance Group shall maintain a catalog of policies, procedures and controls relative to the accounting/reporting processes. These materials shall include documentation describing

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controls over the centralized financial process and data received from remote affiliates and general ledger subsystem interfaces. Decentralized units shall maintain appropriate controls over their particular processes. These financial controls shall be reviewed on a regular basis by internal audit and the external auditors and by the CFO to help ensure that they are designed to ensure timely and accurate financial reporting.

XYZ, INC.
20__ ANNUAL MEETING OF SHAREHOLDERS
PROXY STATEMENT
DISCLOSURE CONTROL TIMELINE

DATE	ACTION ITEM	RESPONSIBLE PARTY	STATUS
_______ (5 mo. Prior to mtg.)	Questionnaires distributed to officers and directors by ___________	CFO	
(4 mo. Prior to mtg.)	Completed questionnaires due back to CFO, copies to be sent to ATTY	BOD	
	Meeting or Written Consent of Board of Directors to: 1. Set date, time and place of Annual Meeting 2. Nominate directors for election 3. Appoint inspector of election and ratify Record Date 4. Direct Transfer Agent to prepare a list of Stockholders entitled to vote at the Annual Meeting	BOD	
	• Initial draft of Audit Committee Report • Review of non-audit services • Evaluate Auditor Independence		
	Prepare Compensation schedules and draft of proxy statement		
	Response to inquiry regarding record date and annual meeting date.	CFO	
	Letter to inform Transfer Agent of proxy agenda.	CFO	
	Broker search cards mailed by Transfer Agent (at least 20 business days prior to Record Date -- Rule 14a-13(a)(3))..	[ADP]	
	Letter to the Depository Trust Company regarding Position listing	CFO	
(3 months prior to mtg.)	Send draft of proxy statement to ATTY and Disclosure Committee for review.	CFO	
(10 days after receipt)	Comments on draft of proxy statement by ATTY and Disclosure Committee.	ATTY; DC	
	Final draft of proxy statement for review.		
	Approve draft of Proxy Statement in substantially final form.		
	Deliver proxy and 10-K to financial printer		

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	File preliminary proxy statement with SEC via EDGAR (at least 10 days prior to mailing proxy solicitation materials. Rule 14a-6(a). May not be required.***		
	Financial printer to deliver Proxy and Annual Report to Transfer Agent		
(67 days prior)	Annual meeting Record Date. ("The record date for determining shareholders entitled to notice of or to vote at any meeting of shareholders or any adjournment thereof, shall not be more than 70 nor less than 10 days before the date of such meeting.")		
(60 calendar days prior to meeting)	Mail/send proxy solicitation materials to shareholders, including Annual Report for fiscal year ending December 31, 2001. ("The Corporation shall mail the annual financial statements to each shareholder within 120 days after the close of each fiscal year") **("the written notice of any meeting shall be given not less than 10 or more than 60 days before the date of the meeting to each shareholder entitled to vote at such meeting")** File definitive proxy statement on Schedule 14D with SEC via Edgar		
(60 calendar days prior to mtg.)	___________mails to brokers and banks. Need 3 business days from receipt (Friday, April 19) to mail date and need 15 calendar days to respond.		
	File 10-K with Securities and Exchange Commission ("SEC").	FP	
	Annual Shareholders Meeting		

* A preliminary proxy statement is not required if the matters to be acted upon at the Annual Meeting of Shareholders are limited to the following:

1. The election of directors
2. The election, approval or ratification of the accountants.
3. A shareholder proposal included pursuant to Rule 14a-8.
4. The approval, ratification or amendment of an employee benefit plan (under certain conditions).

**

*** SEC Regulation 14a-6(b) requires that 3 copies of the proxy materials be sent to NASDAQ. This provision is now voluntary because NASDAQ has undertaken the responsibility for receiving SEC filings via EDGAR.

Responsible Party Definition:

AC Audit Committee
BOD Board of Directors
CFO Chief Financial Officer

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DC	Disclosure Committee
ATTY	Outside Securities Counsel
FP	Financial Printer

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XYZ, INC.

ANNUAL REPORT (FORM10-K)

DISCLOSURE CONTROL TIMELINE

DATES	ACTION ITEM	RESPONSIBLE PARTY	STATUS
12/31/	Close books for Fiscal Year	FIN	
(approx. 3 months)	Annual Audit • Resolution of accounting/disclosure issues	ACCT	
	Distribute initial draft of earnings release • Senior management meeting	FIN, CFO, DC, CEO, AC	
	Distribute second draft of earnings release • Senior management meeting • Legal counsel/auditor review	FIN, DC, CEO, CFO, AC CEO, CFO ATTY, ACCT	
	Auditor "sign-off" on results • Auditor meeting with CFO/CEO	ACCT, FIN	
	Distribute final draft of earnings release • Senior management review meeting and sign off	FIN, DC, CEO, CFO, ACCT, ATTY	
	Audit Committee Meeting (Chairman Only)		
	Issue Earnings Release		
	ATTY Audit Letter	ATTY	
	Distribute initial draft of Form 10-K • Complete GAAP/SEC checklist • Legal counsel SEC rule check • Auditor GAAP/SEC disclosure review	FIN, DC, ACCT, ATTY	
	Disclosure Committee Meeting • Review 10-K • Discuss financial, operational and legal disclosure issues	DC, ATTY	
	Distribute final draft of Form 10-K • Senior management review	DC, ACCT, ATTY, CEO, CFO,	

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	• Audit committee review		
	CEO/CFO review of disclosure controls • Review control process/changes • Review backup certifications • Disclosure committee report • Discretionary meeting with Auditor/Outside counsel	DC, CEO, CFO	
	Audit Committee Meeting • Management review of results/10-K • Auditor discussion of review results • CEO/CFO report on disclosure controls • Audit Committee sign off on 10-K	AC, DC, ACCT, ATTY	
	Senior Executive Final Sign Off of 10-K	CEO, CFO	
	File 10-K and Certifications with SEC	FIN, ACCT, ATTY	
	Filing Deadline		

Responsible Party Definitions:

AC Audit Committee
CEO Chief Executive Officer
CFO Chief Financial Officer
DC Disclosure Committee (CFO, __, ___)
FIN Finance Department
ACCT Outside Auditors
ATTY Outside Securities Counsel

XYZ, INC.
QUARTERLY 10-Q

DISCLOSURE CONTROL TIMELINE

DATES	ACTION ITEM	RESPONSIBLE PARTY	STATUS
	Close books for ___ Quarter	FIN	
	Quarterly SAS 71 Review • Resolution of accounting/disclosure issues	ACCT	
	Distribute initial draft of earnings release • Senior management meeting	FIN, CFO, DC, CEO	
	Distribute second draft of earnings	FIN, DC, CEO, CFO,	

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	release • Senior management meeting • Legal counsel/auditor review	AC CEO, CFO ATTY, ACCT	
	Auditor "sign-off" on results • Auditor meeting with CFO/CEO	ACCT, FIN	
	Distribute final draft of earnings release • Senior management review meeting and sign off	FIN, DC, CEO, CFO, ATTY, ACCT, AC	
	Distribute initial draft of Form 10-Q • Complete GAAP/SEC checklist • Internal/external counsel SEC rule check • Auditor GAAP/SEC disclosure review	FIN, DC, ATTY, HK	
	Disclosure Committee Meeting • Review 10-Q • Discuss financial, operational and legal disclosure issues	DC, HK	
	Distribute final draft of Form 10-Q • Senior management review • Audit committee review	DC, ACCT, ATTY, CEO, CFO,	
	CEO/CFO review of disclosure controls • Review control process/changes • Review backup certifications • Disclosure committee report • Discretionary meeting with auditor/outside counsel	DC, CEO, CFO	
	Audit Committee Meeting • Management review of results/10-Q • Auditor discussion of results • CEO/CFO report on disclosure controls • Audit Committee sign off on 10-Q	AC, DC, ACCT, ATTY	
	Issue Earnings Release		
	Senior Executive Final Sign Off of 10-Q	CEO, CFO	
	File 10-Q and Certifications with SEC	FIN, ATTY, ACCT	
	Filing Deadline		

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Responsible Party Definitions:

AC	Audit Committee	FIN	Finance Department
CEO	Chief Executive Officer	ACCT	Outside Auditors
CFO	Chief Financial Officer	ATTY	Outside Securities Counsel
DC	Disclosure Committee (CFO, ___, ____)		

Sample VII-2: Sample Back-Up Certifications to Section 302 Certification

Certification
to the Chief Executive Officer and the Chief Financial Officer

The undersigned, the ________________________________ of XYZ., Inc. (the "Company"), recognizes that pursuant to 18 U.S.C. §1350 and 15 U.S.C. § 7241, the Chief Executive Officer and the Chief Financial Officer of the Company (collectively, the "Certifying Officers") must make certain certifications in their official capacities, which must be filed with the Company's Report on Form 10-Q for the period beginning _________ __, 20__ and ending ____________ ____, 20__ (the "Report") with the United States Securities and Exchange Commission. The undersigned makes the following representations to the Certifying Officers, understanding that the Certifying Officers in discharging their statutory obligations will rely upon such representations:

(1) The undersigned has reviewed the Report and, in particular, has thoroughly reviewed all portions of the Report directly or indirectly related to the undersigned's area of responsibility at the Company.

(2) To my knowledge, I am not aware of any arrangements, transactions, deals or agreements that have not been properly recorded in the financial records or reported to the Chief Executive Officer or Chief Financial Officer.

(3) I have, to the extent I believe to be necessary, (i) inquired of my subordinates and other Company personnel regarding all portions of the Report directly or indirectly related to my area of responsibility at the Company, and (ii) reviewed appropriate Company records, in each case, in order to ensure the accuracy of the representations set forth in paragraphs (4), (5), (6), and (7) below.

(4) To my knowledge, the information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company, there are no unreported arrangements, transactions, deals or agreements that would have an adverse effect on the information contained in the Report, and I have no reason to believe the Report contains any material inaccuracies or omissions.

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(5) The undersigned understands the Company's internal accounting and disclosure controls and procedures (the "Controls and Procedures"), and is in compliance with those aspects of the Controls and Procedures applicable to the undersigned.

(6) I have disclosed to the Certifying Officers:

(a) all significant deficiencies of which I am aware in the design or operation of the Company's internal accounting or disclosure controls or procedures which could adversely affect the Company's ability to record, process, summarize and report financial and other data; and

(b) any fraud or misconduct involving employees or agents of the Company, whether or not material, known to me.

(7) To my knowledge and in relation to the Company, I have acted in compliance with all applicable laws.

The above certificate is given as of the date of this certificate and is limited to the periods covered by the Report.

The undersigned has executed this certificate on ____________ ____, 20___.

Signature: ________________________________

Name: ___________________________________

Title: ____________________________________

Certification
to the Chief Executive Officer and the Chief Financial Officer

The undersigned, the ______________________________ of XYZ, Inc. (the "Company"), recognizes that pursuant to 18 U.S.C. §1350 and 15 U.S.C. § 7241, the Chief Executive Officer and the Chief Financial Officer of the Company (collectively, the "Certifying Officers") must make certain certifications in their official capacities, which must be filed with the Company's Report on Form 10-K for the period beginning __________ ____, 20__ and ending _________ ____, 20__ (the "Report") with the United States Securities and Exchange Commission. The undersigned makes the following representations to the Certifying Officers, understanding that the Certifying Officers in discharging their statutory obligations will rely upon such representations:

1. I have reviewed the portions of the Report directly or indirectly related to my area of responsibility at the Company.

2. To my knowledge, there have been no unreported arrangements made by the Company or any of its agents with [tailor to particular Company business] regarding, including without limitation, the following:

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[tailor to particular Company business]

3. To my knowledge, I am not aware of any arrangements, transactions, deals or agreements that have not been properly recorded in the financial records or reported to the Chief Executive Officer or Chief Financial Officer.

4. I have, to the extent I believe to be necessary, (i) inquired of my subordinates and other Company personnel regarding all portions of the Report directly or indirectly related to my area of responsibility at the Company, and (ii) reviewed appropriate Company records, in each case, in order to ensure the accuracy of the representations set forth in paragraphs (5), (6) and (7) below.

5. To my knowledge, the information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company, there are no unreported arrangements, transactions, deals or agreements that would have an adverse effect on the information contained in the Report, and I have no reason to believe the Report contains any material inaccuracies or omissions.

6. I have disclosed to the Certifying Officers:

   (a) all significant deficiencies of which I am aware in the design or operation of the Company's internal accounting or disclosure controls or procedures which could adversely affect the Company's ability to record, process, summarize and report financial and other data; and

   (b) any fraud affecting the Company, whether or not material, known to me.

7. To my knowledge and in relation to the Company, I have acted in compliance with all applicable laws.

The above certificate is given as of the date of this certificate and is limited to the periods covered by the Report.

The undersigned has executed this certificate on ____________ ____, 20___.

Signature: ___________________________________

Name: _______________________________

Title: ______________________________________

Sample VII-3: Sample Company Internal Control Reports

[Clean Report – No Material Weaknesses]

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MANAGEMENT'S ANNUAL REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Our management is responsible for establishing and maintaining adequate internal control over financial reporting for the Company. Our internal control over financial reporting is a process designed by, or under the supervision of, our CEO and CFO, and effected by our Board of Directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Our internal control over financial reporting includes those policies and procedures that:

(1) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect our transactions and dispositions of our assets;

(2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and board of directors; and

(3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

Internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives because of its inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. Internal control over financial reporting also can be circumvented by collusion or improper management override. Because of such limitations, there is a risk that material misstatements may not be prevented or detected on a timely basis by internal control over financial reporting. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. However, these inherent limitations are known features of the financial reporting process. Therefore, it is possible to design into the process safeguards to reduce, though not eliminate, this risk.

Management uses the framework in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission, or COSO, to evaluate the effectiveness of our internal control over financial reporting. Management assessed our internal control over financial reporting using the COSO framework as of the end of our fiscal year. Based on our evaluation under the framework in Internal Control – Integrated Framework, we believe our internal control over financial reporting as of____________ ____, 20__ was effective.

[Name of Outside Auditors,] an independent registered public accounting firm that audited our financial statements included in this Annual Report on Form 10-K, has issued an attestation report on management's assessment of our internal control over financial reporting. Such attestation, which expresses unqualified opinions on management's assessment and on the effectiveness of our internal control over financial reporting as of___________ ____, 20__, is included in this Item 8 under the heading "Report of Independent Registered Public Accounting Firm On Internal Control Over Financial Reporting."

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[Report Disclosing One Material Weakness]

Management's Report on Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934. Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Our internal control over financial reporting includes those policies and procedures that:

(i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets;

(ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors; and

(iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

Management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our internal controls will prevent or detect all errors and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of internal controls can provide absolute assurance that all control issues and instances of fraud, if any, have been detected. Also, any evaluation of the effectiveness of controls in future periods are subject to the risk that those internal controls may become inadequate because of changes in business conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Based on the results of our evaluation, management assessed the effectiveness of our internal control over financial reporting as of ____________ ___, 20___. In conducting its assessment of internal control over financial reporting, management based its evaluation on the framework in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). A "material weakness" is a significant deficiency (within the meaning of Public Company Accounting Oversight Board Auditing Standard No. 2), or combination of significant deficiencies, that results in there being more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected on a timely basis by employees in the normal course of their assigned functions. As of __________ ___, 20__, we have identified one material weakness, as described below.

As of ___________ ____, 20___, the Company identified a material weakness in its internal control over financial reporting which resulted from deficiencies in the design and operation of the Company's controls related to the review of accounting for income tax reserves. Although the Company detected errors affecting the income tax reserves and income tax benefit and adjusted the

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consolidated financial statements as of ___________ ___, 20__ to correct the identified errors, the Company has determined that the ineffective controls with respect to the review processes within the Company's tax department result in there being a more than remote likelihood that a material misstatement in the Company's annual or interim financial statements will not be prevented or detected.

Because of the material weakness described above, our management believes that, as of ____________ ____, 20___, we did not maintain effective internal control over financial reporting based on the COSO criteria.

The attestation report concerning management's assessment of the effectiveness of our internal control over financial reporting as of ___________ ___, 20___, issued by ____________, Independent Registered Public Accounting Firm, appears on page ____ of this Report.

[Report Disclosing Multiple Material Weaknesses]

Management's Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over our financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of our financial statements for external reporting purposes in accordance with GAAP. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements.

As of ________ ___, 20__, our management has assessed the effectiveness of our internal control over financial reporting. In making its assessment of internal control over financial reporting, management used the criteria issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control—Integrated Framework. A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. In performing the assessment, management identified the following control deficiencies that we have concluded are material weaknesses in internal control over financial reporting as of __________ ____, 20__:

- *Shortage of, and turnover in, qualified financial reporting personnel to ensure complete application of GAAP.* As a result of a shortage of, and turnover in, qualified financial reporting personnel, controls over financial reporting processes did not function to reduce to remote the likelihood of material misstatements in the application of generally accepted accounting principles to complex, non-routine transactions. This material weakness resulted in adjustments to goodwill related to acquisition reserves, and to interest expense and amortization of debt issuance costs.

- *Insufficient management review of analyses and reconciliations.* The lack of sufficient management review, arising from a shortage of, and turnover in, qualified personnel, of analyses and reconciliations prepared as part of the financial reporting processes did not function to reduce to remote the likelihood that material misstatement of certain accounts in the financial statements would be prevented or detected in a timely manner. This material weakness resulted in adjustments to inventory, cost of sales, deferred compensation and

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additional paid-in-capital.

- *Inaccurate updating of accounting inputs for estimates of complex non-routine transactions.* Controls that reasonably assure the accurate and timely updating of accounting data used in making estimates for financial reporting purposes did not function to reduce to remote the likelihood that errors in the accounting data that could result in material misstatements to related accounting estimates would be prevented or detected in a timely manner, due to the turnover in qualified people with sufficient skills and experience. This material weakness resulted in an adjustment to our accrual for lease commitments on vacated facilities and the related restructuring charges.

- *Accounting for foreign currency exchange transactions.* In the first quarter of the fiscal year, we reported a material weakness in controls over the application of GAAP in the accounting for foreign currency exchange transactions. In spite of improvements in levels of staff with proficiency in GAAP, our controls over the application of GAAP in the accounting for foreign currency contracts as hedges did not sufficiently improve through the remainder of the year and resulted in a year-end adjustment to our statement of operations for unrealized losses on the remeasuring of these contracts to fair market value.

As a result of the material weaknesses described above, management has concluded that, as of ___________ ___, 20___, our system of internal control over financial reporting was not effective based on the criteria in *Internal Control—Integrated Framework*.

Our independent registered public accounting firm, _____________, has issued an audit report on our assessment of our internal control over financial reporting. This report appears below.

[Report Excluding Recent Acquisition]

Management's Annual Report on Internal Control Over Financial Reporting

The financial statements, financial analyses and all other information included in this Annual Report on Form 10-K were prepared by the company's management, which is responsible for establishing and maintaining adequate internal control over financial reporting.

The company's internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. The company's internal control over financial reporting includes those policies and procedures that:

i. pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company;

ii. provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in

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accordance with authorizations of management and directors of the company; and

iii. provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition and use or disposition of the company's assets that could have a material effect on the financial statements.

There are inherent limitations in the effectiveness of any internal control, including the possibility of human error and the circumvention or overriding of controls. Accordingly, even effective internal controls can provide only reasonable assurances with respect to financial statement preparation. Further, because of changes in conditions, the effectiveness of internal controls may vary over time.

Management assessed the design and effectiveness of the company's internal control over financial reporting as of __________ ____, 20___. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control—Integrated Framework*. Based on management's assessment using this framework, it believes that, as of ___________ ___, 20__, the company's internal control over financial reporting is effective.

Management's assessment of the effectiveness of the company's internal control over financial reporting as of ___________ ___, 20___, excluded ABC Corp., which was acquired by the company in ______________ 20__ in a purchase business combination. ABC Corp. is a wholly-owned subsidiary of the company whose total assets and total net sales represented less than ___% of consolidated total assets and less than ___% of consolidated net sales of the company as of and for the fiscal year ended ____________ ____, 20__. Companies are allowed to exclude acquisitions from their assessment of internal control over financial reporting during the first year of an acquisition under guidelines established by the SEC.

Management's assessment of the effectiveness of the company's internal control over financial reporting as of ______________ ____, 20___, has been audited by ____________, an independent registered public accounting firm. Their report expresses an unqualified opinion on management's assessment and on the effectiveness of the company's internal control over financial reporting as of ________________ __, 20___.

Sample VII-4: Sample Auditor Attestation Reports

["Clean" Report – No Material Weaknesses]

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The Board of Directors and Shareholders of XYZ, Inc.

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We have audited management's assessment, included in the accompanying Management's Annual Report on Internal Control Over Financial Reporting, that XYZ, Inc. maintained effective internal control over financial reporting as of _________ ___, 20___, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). XYZ, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that XYZ, Inc. maintained effective internal control over financial reporting as of ____________ ___, 20__, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, XYZ, Inc. maintained, in all material respects, effective internal control over financial reporting as of ___________ ___, 20___, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of XYZ, Inc. and subsidiaries as of __________ ___, 20__ and 20__, and the related consolidated statements of income, shareholders' equity, and cash flows for each of the three years in the period ended _____________ ___, 20__ of XYZ, Inc. and our report dated __________ ____, 20__ expressed an unqualified opinion thereon.

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/s/ ________________

[location]

[date of report]

[Report when One Material Weakness Disclosed]

Report of ______________, Independent Registered Public Accounting Firm

The Board of Directors and Stockholders of XYZ, Inc.

We have audited management's assessment, included in Management's Report on Internal Control Over Financial Reporting in Item 9a, that XYZ, Inc. did not maintain effective internal control over financial reporting as of __________ ____, 20___, because of the effect of the material weakness identified in management's assessment, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). XYZ, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

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Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. The following material weakness has been identified and included in management's assessment:

As of _________ ____, 20__, the Company identified a material weakness in its internal control over financial reporting which resulted from deficiencies in the design and operation of the Company's controls related to the review of accounting for income tax reserves. Although the Company detected errors affecting the income tax reserves and income tax benefit and adjusted the consolidated financial statements as of _________ ___, 20__ to correct the identified errors, the Company has determined that the ineffective controls with respect to the review processes within the Company's tax department result in there being a more than remote likelihood that a material misstatement in the Company's annual or interim financial statements will not be prevented or detected.

This material weakness was considered in determining the nature, timing, and extent of audit tests applied in our audit of the 20___ consolidated financial statements, and this report does not affect our report dated __________ ___, 20__ on those financial statements.

In our opinion, management's assessment that XYZ, Inc. did not maintain effective internal control over financial reporting as of ___________ ____, 20__, is fairly stated, in all material respects, based on the COSO control criteria. Also, in our opinion, because of the effect of the material weakness described above on the achievement of the objectives of the control criteria, XYZ, Inc. has not maintained effective internal control over financial reporting as of ___________ ____, 20__, based on the COSO control criteria.

/s/ _________________

[location]

[date of report]

[Report when Multiple Material Weaknesses Disclosed]

The Board of Directors and Stockholders

XYZ, Inc.

We have audited management's assessment, included in the accompanying Management's Report on Internal Control over Financial Reporting, that XYZ, Inc. did not maintain effective internal control over financial reporting as of _________ ____, 20__, because of the effect of the four material weaknesses identified in management's assessment and described below, based on criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the "COSO control criteria"). The

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Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. The following material weaknesses have been identified and included in management's assessment as of ________ __, 20__:

- *Shortage of, and turnover in, qualified financial reporting personnel to ensure complete application of GAAP.* As a result of a shortage of, and turnover in, qualified financial reporting personnel, controls over financial reporting processes did not function to reduce to remote the likelihood of material misstatements in the application of generally accepted accounting principles to complex, non-routine transactions. This material weakness resulted in adjustments to goodwill related to acquisition reserves, and to interest expense and amortization of debt issuance costs.

- *Insufficient management review of analyses and reconciliations.* The lack of sufficient management review, arising from a shortage of, and turnover in, qualified personnel, of analyses and reconciliations prepared as part of the financial reporting processes did not function to reduce to remote the likelihood that material misstatement of certain accounts in

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the financial statements would be prevented or detected in a timely manner. This material weakness resulted in adjustments to inventory, cost of sales, deferred compensation and additional paid-in-capital.

- *Inaccurate updating of accounting inputs for estimates of complex non-routine transactions.* Controls that reasonably assure the accurate and timely updating of accounting data used in making estimates for financial reporting purposes did not function to reduce to remote the likelihood that errors in the accounting data that could result in material misstatements to related accounting estimates would be prevented or detected in a timely manner, due to the turnover in qualified people with sufficient skills and experience. This material weakness resulted in an adjustment to our accrual for lease commitments on vacated facilities and the related restructuring charges.

- *Accounting for foreign currency exchange transactions.* In the first quarter of the fiscal year, we reported a material weakness in controls over the application of GAAP in the accounting for foreign currency exchange transactions. In spite of improvements in levels of staff with proficiency in GAAP, XYZ, Inc's controls over the application of GAAP in the accounting for foreign currency contracts as hedges did not sufficiently improve through the remainder of the year and resulted in a year-end adjustment to XYZ, Inc.'s statement of operations for unrealized losses on the remeasuring of these contracts to fair market value.

These material weaknesses were considered in determining the nature, timing, and extent of the audit tests applied in our audit of XYZ, Inc.'s 20__ financial statements, and this report does not affect our report dated __________ ___, 20__ on those financial statements.

In our opinion, management's assessment that XYZ, Inc. did not maintain effective internal control over financial reporting as of _____________ ___, 20__, is fairly stated, in all material respects, based on the COSO control criteria. Also, in our opinion, because of the effect of the material weaknesses described above on the objectives of the control criteria, XYZ, Inc. has not maintained effective internal control over financial reporting as of ___________ ___, 20__, based on the COSO control criteria.

____

[location]
[date of report]

[Report Excluding Recent Acquisition]

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders

XYZ, Inc.:

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We have audited management's assessment, included in the accompanying *Management's Annual Report on Internal Control Over Financial Reporting,* that XYZ, Inc.. maintained effective internal control over financial reporting as of __________ ___, 20__, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). XYZ. Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that XYZ Inc. maintained effective internal control over financial reporting as of __________ ___, 20__, is fairly stated, in all material respects, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also, in our opinion, XYZ, Inc. maintained, in all material respects, effective internal control over financial reporting as of ____________ ___, 20__, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Management's assessment of the effectiveness of the Company's internal control over financial reporting as of _______________ ___, 20__, excluded ABC Corp., which was acquired by the Company in __________ 20__ in a purchase business combination. ABC Corp., is a wholly owned subsidiary of the Company whose total assets and net sales represented less than __% of consolidated total assets and less than ___% of consolidated net sales of the Company as of and for the fiscal year

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ended ___________ __, 20__. Our audit of internal control over financial reporting of XYZ, Inc. also excluded an evaluation of the internal control over financial reporting of ABC Corp.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of XYZ, Inc. and subsidiaries as of ___________ ____, 20__ and ___________ ____, 20__, and the related consolidated statements of earnings, stockholders' equity, and cash flows for each of the fiscal years in the three-year period ended __________ ____, 20__, and our report dated __________ ___, 20__, expressed an unqualified opinion on those consolidated financial statements.

/s/ ______________

[location]

[date of report]

Sample VIII-1 :Forms of Section 302 and Section 906 Certifications

Form of Section 302 Certification

Use After Internal Controls Report Compliance Date
(Delete Text in Italics for Use Before That Date)

Exhibit [31._]

CERTIFICATIONS

I, [identify the certifying individual], certify that:

1. I have reviewed this [specify report] of [identify registrant];

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) *and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f))* for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

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(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date:

[Signature]

[Title]

[Note: Provide a separate certification for the CEO and CFO.]

Form of Section 906 Certification

Exhibit [32._]

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO SECTION 906
OF THE SARBANES-OXLEY ACT OF 2002

In connection with the ___________ Report of _______________ [name of issuer] (the "Company") on Form ___ for the year ended _______________ as filed with the Securities and Exchange Commission on the date hereof (the "Form ___"), I, _______________, [Chief Executive Officer][Chief Financial Officer] of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

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(1) The Form ___ fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)); and

(2) The information contained in the Form ___ fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: _________________, 200_

____
[Name]
[Chief Executive Officer]
[Chief Financial Officer]

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to ______________[name of issuer] and will be retained by __________________[name of issuer] and furnished to the Securities and Exchange Commission or its staff upon request.

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Sample IX-1 : Sample Code of Ethics

ABC COMPANY, INC.
CODE OF ETHICS

INTRODUCTION TO THE CODE OF ETHICS

ABC Company's Code of Ethics (the "Code") provides all of us with helpful guidance and stresses ABC's commitment to integrity and honesty. We are all expected to:

- Know and follow the Code.
- Know and comply with the requirements and expectations that apply to our jobs.
- Take responsibility for our own conduct.
- Report suspected violations of the Code to the Compliance & Ethics Officer or otherwise as set forth in the Code.

This Code does not summarize all company policies, laws, rules, and regulations applicable to ABC and its employees, agents, contract workers, officers and directors. It identifies some, but not all, of the compliance risks that apply to our business. Therefore, if you have any questions, please consult your supervisor or manager, ABC's Compliance & Ethics Officer, any member of the ABC Legal Department, Human Resources Department, and the various policies and procedures that ABC has prepared on specific laws, rules, and regulations. In addition, you should never hesitate to call the Compliance & Ethics Helpline at 1-800-555-5555.

PURPOSE AND USE OF THE CODE

The Code of Ethics is a statement of the fundamental principles and key policies that govern the conduct of ABC's business and relationships with our customers, employees, business partners and competitors. This Code is designed to define individual as well as corporate responsibility. You must understand that you are responsible for your own conduct. No one has the authority to make another person violate the Code, and any attempt to direct or otherwise influence someone else to commit a violation is itself a violation of this Code. Alleged violations will be investigated and appropriate action taken.

Asking Questions and Raising Concerns

It is important to note that this Code is designed to serve as a broad outline of the legal and ethical principles adopted by ABC. Because it is not a complete list of all legal or ethical issues you might face in the course of business, this Code must be used along with your common sense and good judgment.

We cannot live up to a commitment to act with integrity if we, as individuals, do not speak up when we should. That is why, in addition to knowing the legal and ethical responsibilities that apply to your job, you must speak up if:

- You are unsure about the proper course of action and need advice.

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- You believe that someone acting on behalf of ABC is doing—or may be about to do—something that violates the law or ABC's policies.
- You have personally engaged in misconduct.

Where to Go for Help

If you are unsure as to the best course of action in a particular situation, or if you have a specific business conduct question, you have options. The most important thing is that you ask the question or raise the concern.

Your supervisor is usually a good place to start with a compliance issue. You may also get help or advice from the Compliance & Ethics Officer, the Legal Department or the human resources department. ABC has also enlisted the use of an external Compliance & Ethics Helpline, if you wish to ask your question *anonymously*. The number for the Compliance & Ethics Helpline is 1-800-555-5555. Any message that you leave on the Helpline will be checked by the Compliance & Ethics Officer. Please leave sufficient details about the problem for the Compliance & Ethics Officer to investigate and follow up. Reports may be made completely anonymous if you wish, and reports will be kept confidential to the extent you desire, in keeping with existing laws and regulations.

Any employee who, in good faith, seeks advice, raises a concern or reports misconduct is following this Code—and doing the right thing. ABC does not permit retaliation of any kind against good faith reports or complaints of violations of this Code or other illegal or unethical conduct.

Violations of the Code

After a possible violation is brought to the company's attention, ABC shall promptly perform an investigation to the extent necessary and appropriate. In the event a violation of the Code has occurred, ABC shall deal with the violator promptly in accordance with corporate disciplinary procedures, including but not limited to the possible termination of the violator's employment with ABC. ABC may also report the conduct to the appropriate authorities.

ABC will be consistent in its enforcement of the Code and in its investigations of reports of violations.

COMPLIANCE WITH LAWS, REGULATIONS & STANDARDS

Regardless of what job you do, there are legal, regulatory and ethical standards that must be considered and upheld. You must strive to be aware of and understand the national, state and local laws—as well as the business requirements and practices—that affect your day-to-day duties, your department's operation and your area of responsibility. Disregard of the laws will not be tolerated, and violations of laws may subject you, as well as ABC, to civil and criminal penalties. Failure to comply with laws may also result in disciplinary action or termination of employment. It is, therefore, in your best interest to know and comply with ABC's legal obligations. You are required to report any violations or suspected violations of applicable law, regulations or corporate policy, including this Code.

Fair Competition Laws

Fair competition laws are designed to ensure that a person who buys goods in the marketplace is able to choose from a variety of products at competitive prices, unrestricted by

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improper constraints such as price-fixing, illegal monopolies or other antitrust law violations. It is ABC's policy to adhere strictly to all applicable fair competition laws.

Anti-Kickback and Bribery Laws

In the United States, and in many other countries, it is illegal to provide, offer or accept a kickback or bribe. A kickback or bribe may be defined as any money, fee, commission, credit, gift, gratuity, thing of value or compensation of any kind that is provided, directly or indirectly, and that has as one of its purposes the improper obtaining or rewarding of favorable treatment in a business transaction. ABC's policy on kickbacks and bribes is clear: they are illegal and are not allowed.

Environmental Laws

It is ABC's policy to manage its business in an environmentally responsible manner. All ABC facilities must implement processes designed to comply with all applicable environmental laws, including those affecting air emissions, water purity and waste disposal. All facilities must have the necessary permits and submit appropriate documentation to government agencies in an accurate and timely manner.

Public Company Reporting Laws

It is ABC's policy to provide full, fair, accurate, timely and understandable disclosure in reports and documents filed with, or submitted to, the U.S. Securities and Exchange Commission or any other regulatory authority and in all other public communications by ABC. The Company also requires that its books and records be maintained in accordance with applicable accounting policies, laws, rules and regulations. These laws require, among other things, that ABC (1) maintain effective disclosure controls and procedures to ensure that all material information relating to ABC and its subsidiaries is made known to the persons responsible for preparing the company's financial reports and (2) have internal control over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. It is also ABC's policy to provide accurate and timely reporting to all taxing authorities.

It is ABC's policy to comply with all financial reporting and accounting regulations. If you have concerns or complaints about questionable accounting or auditing matters, you are encouraged to submit those concerns or complaints—anonymously, confidentially, or otherwise—to the Audit Committee of the Board of Directors. The Audit Committee consists of individuals who are independent from ABC management and are responsible for dealing with both internal and external auditors. You may also call the Compliance & Ethics Helpline at 1-800-555-5555 to raise any concerns confidentially and anonymously.

Insider Trading Laws

There will be times during the course of its business that ABC will need to publicly announce "material" developments regarding its operations. Material information is information that a typical investor might consider important in deciding to buy, sell or hold securities, or information that, if made public, would likely affect the market price of a company's securities. Information may be material even if it relates to future, speculative or contingent events and even if it is significant only when considered in combination with publicly available information.

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ABC policy and securities laws prohibit you from trading securities based on material non-public information. Information becomes public once it has been adequately disclosed and the market has had time to digest the information. Examples of adequate disclosure include the company's announcement of material information through public means, such as news releases or securities filings.

In addition, you should not disclose material non-public information to anyone, including co-workers, unless the person receiving the information has a legitimate need to know the information for purposes of carrying out the company's business. You are also prohibited from disclosing confidential information outside the company.

International Trade & Transactions Laws

Many countries, including the United States, have specific laws regarding the conduct of business with foreign government officials. For example, under the U.S. Foreign Corrupt Practices Act (FCPA), a company (including its shareholders, directors, agents, officers and employees) is prohibited from giving or offering to give anything of value to a foreign official, a foreign political party, a party official or a candidate for political office in order to influence official acts or decisions of that person or entity, to obtain or retain business, or to secure any improper advantage. Indirect payments made through agents, contractors or other third parties are also prohibited.

In addition, it is ABC's policy to comply with all applicable customs, anti-boycott, embargo, and trade control laws, rules and regulations.

Anti-Money Laundering Laws

ABC complies with all applicable anti-money laundering laws, rules and regulations of the United States and other countries having comparable laws. The anti-money laundering laws prohibit us from engaging in a transaction if we know that the funds involved were derived from illegal activities. If you suspect that the other party to a business transaction is engaged in any illegal activity or is using proceeds derived from an illegal activity, you must obtain advice and approval from the Legal Department prior to entering into the transaction.

Political Processes & Political Action Committees (PACs)

ABC strongly believes in the importance of participating in the democratic process, and encourages all of its employees to exercise their right to vote. ABC strictly adheres to federal election laws, which restrict contributions by companies to political candidates. Although ABC may not contribute to candidates, the ABC Political Action Committee (PAC) provides a way for you, as an individual, to contribute. The ABC PAC is authorized by law to make disbursements to political candidates and political party organizations. You may choose to participate in the political process by contributing to the ABC PAC. Participation in the ABC PAC is completely voluntary.

It also is ABC's policy to comply with all applicable laws and regulations relating to lobbying or attempting to influence government officials.

PROFESSIONAL INTEGRITY

Avoiding Conflicts of Interest

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A conflict of interest occurs when your private interest interferes in any way, or even appears to interfere, with the interests of the Company as a whole. A conflict situation can arise when you take actions or have interests that may make it difficult to perform your Company work objectively and effectively. Conflicts of interest also arise when you, or a member of your family, receive improper personal benefits as a result of your position in the Company. Your obligation to conduct the Company's business in an honest and ethical manner includes the ethical handling of actual or apparent conflicts of interest between personal and business relationships. Although we cannot list every conceivable conflict of interest, following are some common examples that illustrate actual, apparent or potential conflicts of interest:

- Outside Employment with a Competitor. You may not compete with ABC or consult with, or be employed in any capacity by, a competitor of ABC. You should consult with ABC's Compliance & Ethics Officer to determine whether a planned activity will compete with any of the Company's business activities before the activity in question is pursued.
- Outside Employment with a Supplier or Customer. Without prior written approval from ABC's Compliance & Ethics Officer, you may not be employed by, serve as a director of, or represent a customer of ABC. Similarly, without prior written approval from ABC's Compliance & Ethics Officer, you may not be a supplier or be employed by, serve as a director of, or represent a supplier to ABC.
- Financial Interests in Other Businesses. Unless specifically authorized by ABC's Compliance & Ethics Officer, you may not own, directly or indirectly, an interest in any business that does or seeks to do business with ABC, or seeks to compete with ABC. However, it is usually not considered a conflict of interest (and, therefore, prior approval is not required) to make investments of no more than 1% of the outstanding securities of a corporation (or ownership interests if an unincorporated business) or of no more than 5% of your total assets.
- Business Arrangements with the Company. Without prior written approval from the Board of Directors, you may not participate in any joint venture, partnership or other business relationship with ABC.
- Corporate Opportunities. You owe a duty to ABC to advance its legitimate interests when the opportunity to do so arises. You may not take personally for yourself opportunities that are discovered through the use of corporate property, information or position, or use corporate property, information or position for personal gain.
- Certain Relationships. You may find yourself in a situation where your spouse, children, parents, in-laws or someone else with whom you have a close relationship is a supplier, customer, competitor or employee of ABC. Such situations are not necessarily prohibited, but they call for extra sensitivity to security, confidentiality and conflicts of interest. Such a situation, however harmless it may appear, could raise suspicions among associates that might affect working relationships. All such situations must be disclosed to ABC's Compliance & Ethics Officer to assess the nature and extent of any concern and how it can be resolved.
- Loans and Guarantees. ABC will not extend or maintain credit, arrange for the extension of credit, or renew an extension of credit in the form of a personal loan to or for any director or executive officer.

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Confidentiality

ABC employees, officers and directors must maintain the privacy of confidential information entrusted to them by ABC or its suppliers or customers, except when disclosure is authorized by ABC's Compliance & Ethics Officer or required by laws, regulations or legal proceedings. Whenever feasible, employees, officers and directors should consult ABC's Compliance & Ethics Officer or Legal Department if they believe they have a legal obligation to disclose confidential information. Confidential information includes all non-public information that might be of use to ABC's competitors, or harmful to ABC or its customers if disclosed.

Business Gifts

In general, the giving or receiving of gifts in return for the use or purchase of ABC products, the recommendation to purchase or use ABC products, or for otherwise doing business with ABC is prohibited. However, gifts, gratuities or courtesies of modest value usually are acceptable. You must consult with your supervisor or with the Compliance & Ethics Officer or Legal Department before giving anything of value to anyone in a position to purchase or influence the purchase of ABC products.

In addition, a gift is likely inappropriate if it would create embarrassment or obligation for the giver or receiver, or if the gift-giving would not stand up to public scrutiny. In receiving gifts, you must ask yourself whether a purpose of a gift is intended to influence, or appear to influence, business decisions and would, therefore, compromise your ability to act in the best interests of ABC. The same tests of integrity should be applied to gifts you are considering offering to a customer or to someone in a position to influence a current or potential customer. You must avoid not only actual impropriety, but also the appearance of impropriety.

Corporate Books and Records

All of ABC's books, records, accounts and financial statements must be maintained in reasonable detail. They must appropriately and accurately reflect ABC's transactions. They must conform to applicable legal requirements and to ABC's system of internal controls. Unrecorded or "off the books" funds or assets should not be maintained unless permitted by applicable law or regulation and with the approval of the Audit Committee of the Board of Directors.

Litigation and Subpoenas

If you learn of a subpoena or a pending or contemplated litigation or government investigation, you should immediately contact ABC's Legal Department. You must retain and preserve all records that may be responsive to the subpoena or relevant to the litigation or that may pertain to the investigation until informed by ABC's legal counsel as to how to proceed.

In addition, once you have learned of a subpoena, litigation or a government investigation, you must also take steps to preserve from destruction all relevant records that, without intervention, would automatically be destroyed or erased (such as e-mails or voicemail messages). Destruction of such records, even if inadvertent, could seriously prejudice the Company. If you have any questions regarding whether a particular record pertains to a pending or contemplated investigation or litigation or may be responsive to a subpoena, you should preserve the record in question and ask ABC's Legal Department for advice.

For more detailed instructions on the preservation of records, please consult ABC's Record Retention Policy and Procedures.

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RESPECT FOR OUR PEOPLE & CUSTOMERS

Health and Safety

ABC strives to provide each employee with a clean, safe and healthy place to work. To achieve that goal, all employees must understand the shared responsibilities of abiding by all safety rules and practices, taking the necessary precautions to protect oneself and coworkers, and reporting immediately any unsafe conditions, practices or accidents.

Drugs & Alcohol

Work requires clear thinking and, often, the ability to react quickly. Being under the influence of alcohol or drugs or improperly using medication diminishes your ability to perform at your best.

It is ABC's policy to prohibit the sale, use, possession or influence of alcohol or non-prescription controlled substances, including illegal drugs, on ABC property. If you observe any drug or alcohol abuse, you should report it to your supervisor, the Human Resources Department, or the Compliance & Ethics Officer.

Diversity

ABC welcomes diversity in its workplace and among its customers and suppliers. ABC is committed to equal employment without regard to race, color, religion, sex, national origin, age, medical condition or disability, sexual orientation, veteran status or any other characteristic protected by law.

Conduct in the Workplace

We are all expected to treat others with respect and fairness. Workplace harassment is any unwelcome or unwanted attention or discriminatory conduct based on an individual's race, color, religion, sex, national origin, age, medical condition or disability, sexual orientation, veteran status or any other illegal or inappropriate basis. It can also include verbal, nonverbal or physical abuse. Something that is considered harmless by one individual may be perceived as harassment by another. You are expected to conduct yourself in a manner appropriate to the workplace, to keep all work environments free of harassment, and to conduct relationships with appropriate behavior and integrity.

Employee Privacy

ABC respects every employee's right to confidentiality of certain employment records, including certain health information, as well as the privacy of personal activities outside of business hours. ABC collects and maintains personal information that relates to each employee, including medical and benefit information. ABC takes special care to limit access to personal information to company personnel who need to know such information for a legitimate purpose. Employees who are responsible for maintaining personal information, and those who are provided access to such information must not disclose it inappropriately.

ABC has rights of access to all company property, including computers, and all communications, e-mail and voicemail messages, records and information created in the business setting, regardless of whether the individual considers the information or communication to be private.

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Use of Information Systems (Computers)

Information systems—the hardware, software and data that is stored processed and reported—is critical to business success. Examples include your desktop or laptop computer, telephones, file servers and network, and e-mail messages. All employees must use these systems responsibly and primarily for legitimate business purposes. ABC policy prohibits the use of its information systems for the purpose of:

- Engaging in communications that might be considered illegal, offensive, defamatory, harassing, obscene, vulgar, or otherwise disruptive to normal business activity.
- Visiting inappropriate Internet sites.
- Improperly disseminating copyrighted or licensed materials or confidential and proprietary information.
- Installing hardware or software without advance authorization from ABC's Information Technology (IT) Department.

Any communications you have at work (e-mail, voicemail, etc.) are not necessarily private. Records of your communications may be made and used for a variety of reasons, and may be monitored to verify that company policies are being followed. Keep this in mind, and follow the guidelines above to ensure compliance.

Company Assets

ABC's assets include its facilities, computers, inventory, trade secrets, office supplies, equipment, products, confidential information, and funds. All employees are responsible for using good judgment to ensure that these assets are not misused or wasted. Theft, carelessness and waste have a direct impact on ABC's profitability. Also, any misuse or misappropriation of ABC's assets may be considered criminal and can bring severe consequences.

Sample XI-1: Sample Insider Trading/Pre-Clearance Policies

XYZ, INC.

STATEMENT OF POLICY ON

SECURITIES TRADES BY COMPANY PERSONNEL

______________ ____, 20__

TO: **All Employees, Officers and Directors of XYZ, Inc. (the "Company")**

FROM: [CEO]

RE: **Statement of Company Policy**
Securities Trades By Company Personnel

<u>The Need For A Policy Statement</u>

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The purchase or sale of securities while aware of material nonpublic information, or the disclosure of material nonpublic information to others who then trade in the Company's securities, is prohibited by the federal securities laws. Insider trading violations are pursued vigorously by the SEC and the U.S. Attorneys and are punished severely. While the regulatory authorities concentrate their efforts on the individuals who trade, or who tip inside information to others who trade, the federal securities laws also impose potential liability on companies and other "controlling persons" if they fail to take reasonable steps to prevent insider trading by company personnel.

The Company's Board of Directors has adopted this Policy Statement both to satisfy the Company's obligation to prevent insider trading and to help Company personnel avoid the severe consequences associated with violations of the insider trading laws. The Policy Statement also is intended to prevent even the appearance of improper conduct on the part of anyone employed by or associated with the Company (not just so-called insiders). We have all worked hard over the years to establish a reputation for integrity and ethical conduct, and we can not afford to have that reputation damaged.

The Consequences

The consequences of an insider trading violation can be severe:

Traders and Tippers. Company personnel (or their tippees) who trade on inside information are subject to the following penalties:

- A civil penalty of up to three times the profit gained or loss avoided;
- A criminal fine of up to $1,000,000 (no matter how small the profit); and
- A jail term of up to ten years.

An employee who tips information to a person who then trades is subject to the same penalties as the tippee, even if the employee did not trade and did not profit from the tippee's trading.

Control Persons. The Company and its supervisory personnel, if they fail to take appropriate steps to prevent illegal insider trading, are subject to the following penalties:

- A civil penalty of up to $1,000,000 or, if greater, three times the profit gained or loss avoided as a result of the employee's violation; and
- A criminal penalty of up to $2,500,000 dollars.

Company-Imposed Sanctions. An employee's failure to comply with the Company's insider trading policy may subject the employee to Company-imposed sanctions, including dismissal for cause, whether or not the employee's failure to comply results in a violation of law. Needless to say, a violation of law, or even an SEC investigation that does not result in prosecution, can tarnish one's reputation and irreparably damage a career.

Statement of Policy

It is the policy of the Company that no director, officer or other employee of the Company who is aware of material nonpublic information relating to the Company may, directly or through family members or other persons or entities, (a) buy or sell securities of the Company (other than pursuant to a pre-approved trading plan that complies with SEC Rule 10b5-1), or engage in any other action

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to take personal advantage of that information, or (b) pass that information on to others outside the Company, including family and friends. In addition, it is the policy of the Company that no director, officer or other employee of the Company who, in the course of working for the Company, learns of material nonpublic information about a company with which the Company does business, including a customer or supplier of the Company, may trade in that company's securities until the information becomes public or is no longer material.

Transactions that may be necessary or justifiable for independent reasons (such as the need to raise money for an emergency expenditure) are not excepted from the policy. The securities laws do not recognize such mitigating circumstances, and, in any event, even the appearance of an improper transaction must be avoided to preserve the Company's reputation for adhering to the highest standards of conduct.

Disclosure Of Information To Others. The Company is required under Regulation FD of the federal securities laws to avoid the selective disclosure of material nonpublic information. The Company follows procedures for releasing material information in a manner that is designed to achieve broad public dissemination of the information immediately upon its release. You may not, therefore, disclose information to anyone outside the Company, including family members and friends, other than in accordance with those procedures. You also may not discuss the Company or its business in an internet "chat room" or similar internet-based forum.

Material Information. Material information is any information that a reasonable investor would consider important in making a decision to buy, hold, or sell securities. Any information that could be expected to affect the Company's stock price, whether it is positive or negative, should be considered material. Some examples of information that ordinarily would be regarded as material are:

- Projections of future earnings or losses, or other earnings guidance;
- Earnings that are inconsistent with the consensus expectations of the investment community;
- A pending or proposed merger, acquisition or tender offer;
- A pending or proposed acquisition or disposition of a significant asset;
- A change in dividend policy, the declaration of a stock split, or an offering of additional securities;
- A change in management;
- Development of a significant new product or process;
- Impending bankruptcy or the existence of severe liquidity problems;
- The actual or potential gain or loss of a significant customer or contract.

Twenty-Twenty Hindsight. Remember, anyone scrutinizing your transactions will be doing so after the fact, with the benefit of hindsight. As a practical matter, before engaging in any transaction, you should carefully consider how enforcement authorities and others might view the transaction in hindsight.

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When Information is "Public." If you are aware of material nonpublic information, you may not trade until the information has been disclosed broadly to the marketplace (such as by press release or an SEC filing) and the investing public has had time to absorb the information fully. To avoid the appearance of impropriety, as a general rule, information should not be considered fully absorbed by the marketplace until after the second business day after the information is released. If, for example, the Company were to make an announcement on a Monday, you should not trade in the Company's securities until Thursday. If an announcement were made on a Friday, Wednesday generally would be the first eligible trading day.

Transactions by Family Members. The insider trading policy also applies to your family members who reside with you, anyone else who lives in your household, and any family members who do not live in your household but whose transactions in company securities are directed by you or are subject to your influence or control (such as parents or children who consult with you before they trade in company securities). You are responsible for the transactions of these other persons and therefore should make them aware of the need to confer with you before they trade in the Company's securities.

Transactions Under Company Plans

Stock Option Exercises. The Company's insider trading policy does not apply to the exercise of an employee stock option, or to the exercise of a tax withholding right pursuant to which you elect to have the Company withhold shares subject to an option to satisfy tax withholding requirements. The policy does apply, however, to any sale of stock as part of a broker-assisted cashless exercise of an option, or any other market sale for the purpose of generating the cash needed to pay the exercise price of an option.

Employee Stock Purchase Plan. The Company's insider trading policy does not apply to purchases of Company stock in the Company's employee stock purchase plan resulting from your periodic contribution of money to the plan pursuant to the election you made at the time of your enrollment in the Plan. The policy also does not apply to purchases of Company stock resulting from lump sum contributions to the Plan, provided that you elected to participate by lump-sum payment at the beginning of the applicable enrollment period. The policy does apply to your election to participate in the plan for any enrollment period, and to your sales of Company stock purchased pursuant to the plan.

Additional Prohibited Transactions

The Company considers it improper and inappropriate for any director, officer or other employee of the Company to engage in short-term or speculative transactions in the Company's securities. It therefore is the Company's policy that directors, officers and other employees may not engage in any of the following transactions:

Short Sales. Short sales of the Company's securities evidence an expectation on the part of the seller that the securities will decline in value, and therefore signal to the market that the seller has no confidence in the Company or its short-term prospects. In addition, short sales may reduce the seller's incentive to improve the Company's performance. For these reasons, short sales of the Company's securities are prohibited by this Policy Statement. In addition, Section 16(c) of the Exchange Act prohibits officers and directors from engaging in short sales.

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Hedging Transactions. Certain forms of hedging or monetization transactions, such as zero-cost collars and forward sale contracts, allow an employee to lock in much of the value of his or her stock holdings, often in exchange for all or part of the potential for upside appreciation in the stock. These transactions allow the director or employee to continue to own the covered securities, but without the full risks and rewards of ownership. When that occurs, the director or employee may no longer have the same objectives as the Company's other shareholders. Therefore, the Company strongly discourages you from engaging in such transactions. Any person wishing to enter into such an arrangement must first pre-clear the proposed transaction with the Company's Chief Financial Officer. Any request for pre-clearance of a hedging or similar arrangement must be submitted to the Chief Financial Officer at least two weeks prior to the proposed execution of documents evidencing the proposed transaction and must set forth a justification for the proposed transaction.

Margin Accounts and Pledges. Securities held in a margin account may be sold by the broker without the customer's consent if the customer fails to meet a margin call. Similarly, securities pledged (or hypothecated) as collateral for a loan may be sold in foreclosure if the borrower defaults on the loan. Because a margin sale or foreclosure sale may occur at a time when the pledgor is aware of material nonpublic information or otherwise is not permitted to trade in Company securities, directors, officers and other employees are prohibited from holding Company securities in a margin account or pledging Company securities as collateral for a loan. An exception to this prohibition may be granted where a person wishes to pledge Company securities as collateral for a loan (not including margin debt) and clearly demonstrates the financial capacity to repay the loan without resort to the pledged securities. Any person who wishes to pledge Company securities as collateral for a loan must submit a request for approval to the Chief Financial Officer at least two weeks prior to the proposed execution of documents evidencing the proposed pledge.

Additional Information and Requirements

Post-Termination Transactions. The Policy Statement continues to apply to your transactions in Company securities even after you have terminated employment. If you are in possession of material nonpublic information when your employment terminates, you may not trade in Company securities until that information has become public or is no longer material.

Company Assistance. Any person who has a question about this Policy Statement or its application to any proposed transaction may obtain additional guidance from Ron Alexander, our Chief Financial Officer, whose telephone number is 703-329-9400. Ultimately, however, the responsibility for adhering to this Policy Statement and avoiding unlawful transactions rests with the individual employee.

Certifications. All employees must certify their understanding of, and intent to comply with, this Policy Statement. A copy of the certification that all employees (other than executive officers) must sign is enclosed with this memorandum. Directors, executive officers and certain other employees are subject to additional restrictions on their transactions in Company securities, which are described in a separate memorandum. Directors, executive officers and such other employees should sign the certification attached to that memorandum instead of the one enclosed with this memorandum.

CERTIFICATIONS

I certify that:

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1. I have read and understand the Company's Statement of Policy regarding Securities Trades by Company Personnel dated November 4, 2002. I understand that the Company's Chief Financial Officer is available to answer to any questions I have regarding the Statement of Policy.

2. Since November 4, 2002, or such shorter period of time that I have been an employee of the Company, I have complied with the Statement of Policy.

3. I will continue to comply with the Statement of Policy for as long as I am subject to the policy.

Signature:______________________

Date:__________________________

Print name:_____________________

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MEMORANDUM ____________ ___, 20__

TO: Directors, Executive Officers and 10% Stockholders of XYZ, Inc.

FROM: CEO

RE: Insider Reporting and Trading

We want to inform you of certain procedures we are implementing to ensure compliance with insider reporting requirements and take this opportunity to remind you of your obligations under insider trading rules.

As a director, executive officer or 10% stockholder of XYZ, Inc., you are subject to SEC rules governing the reporting of insider transactions and the imposition of short-swing profit liability under Section 16 of the Securities Exchange Act of 1934. These obligations also apply to transactions made by your affiliates, including entities owned or controlled by you, and members of your immediate family living in your household.

SOX has caused significant changes in the rules relating to stock transaction reporting by insiders. Under rules adopted by the SEC pursuant to Sarbanes-Oxley, all insiders of XYZ (directors, officers and 10% stockholders) are required to file stock transaction reports (Form 4s) **by the end of the second business day following the date of a stock transaction**. Under the old rules, these reports were due by the 10th day of the month following the month in which the transaction took place. In addition, the new rules extend the two-day reporting requirement to stock option transactions, including option grants, exercises, cancellations and repricings. Under the old rules, many of these transactions were subject to substantially deferred reporting requirements.

In order to ensure compliance with the accelerated reporting requirements, we are implementing new procedures regarding insider transactions. **Effective immediately, you must contact ________________, or in his (her) absence, ________________, at least three (3) business days before you intend to engage in any transaction involving XYZ common stock, and pre-clear such transaction with us.** This requirement covers not only purchases and sales, but also gifts, transfers to trusts, option exercises and any "swap" transactions. Contacting ____________ or _____________ will permit us to address any short-swing liability or insider trading issues, and to prepare in advance required SEC reports (such as a Form 4) to ensure compliance with the new two-day reporting requirement.

We would also like to take this opportunity to remind you of your obligations under insider trading rules. The purchase or sale of securities while aware of material nonpublic information, or the disclosure of material nonpublic information to others who then trade in XYZ securities, is prohibited by the federal securities laws. Our existing insider trading policy prohibits you from

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trading in XYZ securities while in possession of material nonpublic information about the Company. In addition, our existing policy imposes blackout periods that restrict trading in XYZ stock during specified periods. From time to time, we may also institute ad hoc blackout periods on your trading activities due to Company developments. In this era of increased scrutiny of corporate compliance and especially of insider activities, it is imperative that you are aware of, and comply with, such restrictions to avoid both personal liability and adverse effects on the Company.

Please do not hesitate to contact ___________________ or ____________________ with any questions you may have about transactions in the Company's common stock or our new pre-clearance procedure. Thank you in advance for your cooperation.

XYZ, INC.

SPECIAL POLICY AND PROCEDURES

REGARDING

SECURITIES TRADES BY DIRECTORS, EXECUTIVE OFFICERS AND

KEY PERSONNEL

_____________ ___, 20__

TO: **Directors, Executive Officers and Other Key Employees of XYZ, Inc. (the "Company")**

FROM: **CEO**

RE: **Transactions Involving Company Securities – Pre-Clearance (and Blackout Periods) Procedures**

This memorandum describes the procedures governing transactions in Company securities by directors executive officers, including procedures to address the two-day Form 4 filing requirement applicable to all directors and executive officers subject to Section 16 of the Securities Exchange Act of 1934 (the "Exchange Act"). Certain of the procedures apply also to non-executive employees who regularly become aware of earnings information or other material nonpublic information about the Company.

Pre-clearance Procedures

To help prevent inadvertent violations of the federal securities laws and to avoid even the appearance of trading on inside information, directors and executive officers of the Company and any other persons designated by _________________ or __________________ as being subject to the Company's pre-clearance procedures, together with their family members, may not engage in any transaction involving the Company's securities (including a stock plan transaction such as an option exercise, gift, loan or pledge or hedge, contribution to a trust, or any other transfer) without first obtaining pre-clearance of the transaction from _________________ or, in his (her) absence, ____________________. A request for pre-clearance should be submitted to ______________ or, in his (her) absence, __________________ at least three (3) business days in advance of the

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proposed transaction. Such officer is under no obligation to approve a trade submitted for pre-clearance, and may determine not to permit the trade.

Any person subject to the pre-clearance requirements who wishes to implement a trading plan under SEC Rule 10b5-1 must first pre-clear the plan with ______________________ or ________________. As required by Rule 10b5-1, you may enter into a trading plan only when you are not in possession of material nonpublic information. In addition, you may not enter into a trading plan during a blackout period (as described below). Transactions effected pursuant to a pre-cleared trading plan under Rule 10b5-1 will not require further pre-clearance at the time of the transaction if the plan specifies the dates, prices and amounts of the contemplated trades, or establishes a formula for determining the dates, prices and amounts.

Blackout Periods

Quarterly Blackout Periods. The Company's announcement of its quarterly financial results almost always has the potential to have a material effect on the market for the Company's securities. Therefore, you can anticipate that, to avoid even the appearance of trading while aware of material nonpublic information, persons who are or may be expected to be aware of the Company's quarterly financial results generally will not be pre-cleared to trade in the Company's securities during the period beginning _______________ [weeks][days] prior to the end of the Company's fiscal quarter and ending after the second full business day following the Company's issuance of its quarterly earnings release or analyst conference call. Persons subject to these quarterly blackout periods include all directors and executive officers, all employees of the accounting department, and all other persons who are informed by _______________ or _________________ that they are subject to the quarterly blackout periods.

For illustrative purposes, the following dates are the quarterly blackout periods during which the directors, executive officers and employees described above, and their family members, are prohibited from trading in Company stock:

Blackout Period Start Date	Blackout Period End Date
December ___	Two Business Days following release of 4th quarter and previous year's financial results.
March ___	Two Business Days following release of 1st quarter financial results.
June ___	Two Business Days following release of 2nd quarter financial results.
September ____	Two Business Days following release of 3rd quarter financial results.

Event-specific Blackout Periods. From time to time, an event may occur that is material to the Company and is known by only a few directors or executives. So long as the event remains material and nonpublic, directors, executive officers, and such other persons as are designated by _______________ or _______________ may not trade in the Company's securities. The existence of an event-specific blackout will not be announced, other than to those who are aware of the event giving rise to the blackout. If, however, a person whose trades are subject to pre-clearance requests permission to trade in the Company's securities during an event-specific blackout,

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___________________ or ______________ will inform the requester of the existence of a blackout period, without disclosing the reason for the blackout. Any person made aware of the existence of an event-specific blackout should not disclose the existence of the blackout to any other person. The failure of ________________ or ______________ to designate a person as being subject to an event-specific blackout will not relieve that person of the obligation not to trade while aware of material nonpublic information.

Hardship Exceptions. A person who is subject to a quarterly earnings blackout period and who has an unexpected and urgent need to sell Company stock in order to generate cash may, in appropriate circumstances, be permitted to sell Company stock even during the blackout period. Hardship exceptions may be granted only by ________________ or ____________ and must be requested at least two business days in advance of the proposed trade. A hardship exception may be granted only if the ______________________ or _____________ concludes that the Company's earnings information for the applicable quarter does not constitute material nonpublic information. Under no circumstance will a hardship exception be granted during an event-specific blackout period.

Short-Swing Trading

No director, officer or beneficial holder of more than 10% of the Company's common stock may engage in a transaction that gives rise to liability to disgorge profits under Section 16(b) of the Exchange Act. Under Section 16(b) of the Exchange Act, insiders will be liable for any profits they receive upon the sale and purchase, or the purchase and sale, of the Company's stock within a six-month period. In other words, if you both buy and sell stock within any six-month period, you will be liable to the Company for the excess of your sales price over your purchase price. This liability can exist regardless of the order of the transactions. For example, if you sell a share of stock at $10.00 and then buy a share of stock within six months at $7.00, you will be liable to the Company for $3.00. This liability is known as a "short-swing profit."

The liability does not depend on whether you have inside information when you make one of the trades. It also does not depend on whether the transactions are in the public market or are private. The liability simply depends on whether the transactions occur within six months of each other.

The SEC has exempted a few transactions from short-swing liability. However, you should assume that each transaction is not exempt unless you have received competent legal advice to the contrary.

General

Post-Termination Transactions. If you are aware of material nonpublic information when you terminate service as a director, officer or other employee of the Company, you may not trade in the Company securities until that information has become public or is no longer material. In all other respects, the procedures set forth in this memorandum will cease to apply to your transactions in Company securities upon the expiration of any "blackout period" that is applicable to your transactions at the time of your termination of service.

Company Assistance. Any person who has a question about this memorandum or its application to any proposed transaction may obtain additional guidance from___________________ or ________________.

Certifications. All directors, officers and other employees subject to the procedures set forth in this memorandum must certify their understanding of, and intent to comply with, the Company's

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insider trading policy, including the procedures set forth in this special policy. Please return the enclosed certification immediately.

Power of Attorney

In order to enable the company to prepare and file Forms 4 with the SEC on a timely basis (now 2 business days following the date of the transaction in most cases), it is imperative that you sign and return immediately the enclosed power of attorney.

CERTIFICATION

I certify that:

1. I have read and understand the Company's Statement of Policy regarding Securities Trades by Company Personnel dated_______________ _____, 20__ and the Special Policy and Procedures regarding Securities Trades by Directors, Executive Officers and Other Key Employees dated ____________________ _____, 20___ covering pre-clearance procedures and blackout periods (collectively, the "insider trading policy"). I understand that ________________ or ________________ is available to answer any questions I have regarding the insider trading policy.

2. Since ______________ __, 20__, or such shorter period of time that I have been an employee or director of the Company, I have complied with the insider trading policy.

3. I will continue to comply with the insider trading policy for as long as I am subject to the policy.

Signature:_______________________________

Date:___________________________________

Print name:_____________________________

Sample XIII-1 : Sample Department of Labor and Director and Officer Notices under SOX 306

Model Notice
of Blackout Periods under Individual Account Plans

Important Notice Concerning Your Rights

Under The [*Enter Name of Individual Account Plan*]

[*Enter date of notice*]

1. This notice is to inform you that the [*enter name of plan*] will be [*enter reasons for blackout period, as appropriate: changing investment options, changing recordkeepers, etc*.].

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2. As a result of these changes, you temporarily will be unable to [*enter as appropriate: direct or diversify investments in your individual accounts (if only specific investments are subject to the blackout, those investments should be specifically identified), obtain a loan from the plan, or obtain a distribution from the plan*]. This period, during which you will be unable to exercise these rights otherwise available under the plan, is called a "blackout period." Whether or not you are planning retirement in the near future, we encourage you to carefully consider how this blackout period may affect your retirement planning, as well as your overall financial plan.

3. The blackout period for the plan [*enter the following as appropriate: is expected to begin on [enter date] and end [enter date]/is expected to begin during the week of [enter date] and end during the week of [enter date]. During these weeks, you can determine whether the blackout period has started or ended by [enter instructions for use toll-free number or accessing web site*].

4. [*In the case of investments affected by the blackout period, add the following: During blackout period you will be unable to direct or diversify the assets held in your plan account. For this reason, it is very important that you review and consider the appropriateness of your current investments in light of your inability to direct or diversify those investments during the blackout period. For your long-term retirement security, you should give careful consideration to the importance of a well-balanced and diversified investment portfolio, taking into account all your assets, income and investments.*]

[*If the plan permits investments in individual securities, add the following: You should be aware that there is a risk to holding substantial portions of your assets in the securities of any one company, as individual securities tend to have wider price swings, up and down, in short periods of time, than investments in diversified funds. Stocks that have wide price swings might have a large loss during the blackout period, and you would not be able to direct the sale of such stocks from your account during the blackout period.*]

5. [*If timely notice cannot be provided enter: (A) Federal law generally requires that you be furnished notice of a blackout period at least 30 days in advance of the last date on which you could exercise your affected rights immediately before*

the commencement of any blackout period in order to provide you with sufficient time to consider the effect of the blackout period on your retirement and financial plans. (B) [Enter explanation of reasons for inability to furnish 30 days advance notice.]]

6. If you have any questions concerning this notice, you should contact [*enter name, address and telephone number of the plan administrator or other contact responsible for answering questions about the blackout period*]

Sample Director and Office Notice

Company Letterhead

__________ __, 20__

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To: Directors and Section 16 Officers of XYZ, Inc.

From:

Subject: 401(k) Plan Blackout Period

This is to notify you of an upcoming blackout period under the XYZ, Inc. ("XYZ") 401(k) plan. During this trading blackout, your ability to conduct transactions in XYZ equity securities will be limited. We expect the blackout period to begin ___________ ___, 20__ and end _________________ ___, 20__.

The blackout period will allow [give reason for blackout]. During the blackout period, participants will be unable to direct investments or change the assets held in their plan accounts or obtain a loan, withdrawal, or distribution from the 401(k) plan. Participants have been notified of the blackout period as of the date of this letter.

In addition, because the 401(k) plan offers XYZ common stock as an investment option, pursuant to Section 306 of the Sarbanes-Oxley Act of 2002 XYZ directors and Section 16 officers are not permitted to trade in XYZ equity securities (including the exercise of any options or the sale of any restricted stock) while the 401(k) participants are unable to complete transactions in the 401(k) plan. This prohibition applies to XYZ equity securities you hold both inside and outside the 401(k) Plan.

Gifts, dividend reinvestments and trading pursuant to a previously established 10b5-1 trading plan are exempt from this prohibition.

This notice is in addition to any other normal trading restrictions contained in XYZ other policies and procedures, including its [name of insider trading policy/special insider trading procedures].

If you have any questions, please do not hesitate to contact me at ___________.

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XIX. About the Firm

Holland & Knight LLP's Securities and Public Companies Team regularly advise public and private companies in a broad range of domestic and international securities offerings. Team lawyers are also well versed in securities law and regulatory compliance matters affecting public companies. In addition to public companies, Holland & Knight regularly represents underwriters, placement agents, private equity funds and venture capital firms in capital raising transactions.

Contributors Biographies

Jane K. P. Tam acts as principal outside counsel for domestic and foreign companies on securities offerings, SEC compliance and periodic filings, corporate governance, mezzanine investments, venture capital financings, mergers and acquisitions, research and collaboration agreements, strategic partnering and distributorships, and general corporate matters. She represents private and public issuers, private equity funds and investment banks in public offerings and private placements of securities, debt financings, exchange offers and shelf registration of securities. Ms. Tam also counsels public companies on corporate governance and disclosure issues, shareholder relations and compliance with the Sarbanes-Oxley Act of 2002, the federal and state securities laws, the rules and regulations of the NYSE, the NASDAQ and other major stock exchanges. Ms. Tam is a frequent speaker on capital formation, corporate governance, and diversity issues.

Mark J. Tarallo, primarily a corporate and securities lawyer, represents both public and private companies, from start-up companies to publicly traded multi-national corporations. He has represented both buyers and sellers in mergers and acquisitions, and has counseled clients in connection with public and private offerings of securities. In the area of corporate law, Mr. Tarallo has advised clients with respect to corporate structure and formation, capital raising, employment and general commercial matters. Mr. Tarallo has assisted clients with numerous debt financings, representing both borrowers and lenders. He has also counseled family-owned businesses with respect to succession planning and buyouts.

Jonathan F. Wolcott practices in the areas of securities, mergers and acquisitions and corporate law. Mr. Wolcott represents a wide range of public and private companies, investment banks, private equity funds and individual investors in structuring and executing public and private equity and debt offerings, mergers, acquisitions, dispositions and other change of control transactions, mezzanine investments and venture capital financings. He also counsels public companies in connection with the preparation of periodic reports and proxy statements, compliance with Securities and Exchange Commission and stock market rules, corporate governance matters and the preparation of employee compensation plans and executive employment agreements.

Jennifer E. Dure is a member of Holland & Knight's Litigation Team. She focuses on representation of clients in matters involving corporate compliance, white-collar defense and commercial litigation. Ms. Dure's practice includes advising companies in the design and implementation of comprehensive compliance and ethics programs, conducting internal compliance investigations and defending companies that are the subject of government investigations. In addition, Ms. Dure has experience handling commercial contract disputes, employment claims, and various health care matters, including those involving Medicare fraud and abuse laws.

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