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June 9, 2003

SEC Implements Internal Control Provisions of Sarbanes-Oxley Act

The Securities and Exchange Commission (SEC) recently approved rules and developed guidelines to implement the requirements of Section 404 of the Sarbanes-Oxley Act (the Act) of 2002. In its rulemaking, the SEC also established key dates for the implementation of these requirements.

In short, "accelerated filers" will be required to comply with the rules about management's report on internal controls for fiscal years ending on or after June 15, 2004. All other issuers will be required to comply for their fiscal years ending on or after April 15, 2005.

The following provides more detail about these provisions as released by the SEC May 27.

Management's Report on Internal Control Over Financial Reporting

Section 404 of the Act directed the SEC to adopt rules requiring an annual internal control report of a company, other than a registered investment company. The report must contain:

- ✓ A statement of management's responsibility for establishing and maintaining an adequate internal control structure and procedures for financial reporting
- ✓ Management's assessment, as of the end of the company's most recent fiscal year, of the effectiveness of the company's internal control structure and procedures for financial reporting

In addition, under the SEC's final

rules, management's annual internal control report also must contain:

- ✓ A statement identifying the framework used by management to evaluate the effectiveness of this internal control
- ✓ A statement that its auditor has issued an attestation report on management's assessment

The auditor's report must comply with the standards established by the Public Company Accounting Oversight Board. Those standards have not yet been finalized.

Under the new rules, management must disclose any material weakness and will be unable to conclude that the company's internal control over financial reporting is effective if there are one or more material weaknesses in such control.

Furthermore, the framework on which management's evaluation is based will have to be a suitable, recognized control framework established by a body or group that has followed due-process procedures, including the broad distribution of the framework for public comment.

The new rules implementing Section 404 of the Act define the term "internal control over financial reporting" to mean a process designed by, or under the supervision of, the registrant's principal executive and principal financial officers, or persons performing similar functions, and effected by the registrant's board of directors, management and other personnel, to provide reasonable assurance regarding the reli-

ability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

In addition, internal control over financial reporting should include policies and procedures that:

- ✓ Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the registrant
- ✓ Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and receipts and expenditures of the registrant are being made only in accordance with authorizations of management and directors of the registrant
- ✓ Provide reasonable assurance about prevention or timely detection of unauthorized acquisition, use or disposition of the registrant's assets that could have a material effect on the financial statements

The SEC also voted to adopt amendments requiring companies to perform quarterly evaluations of changes within the company that have materially affected or are reasonably likely to materially affect the company's internal control over financial reporting.



Effective Date

Compliance with the rules for management's report on internal controls is as follows:

- ✓ Companies, other than foreign private issuers, meeting the definition of an "accelerated filer" in Exchange Act Rule 12b-2 will be required to comply with the management report on internal control over financial reporting requirements for fiscal years ending on or after June 15, 2004
- ✓ All other issuers, including small business issuers and foreign private issuers, will be required to comply for their fiscal years ending on or after April 15, 2005

Certifications - Public Companies

The final rules will amend the exhibit requirements for periodic

reports to add the certifications required by Sections 302 and 906 of the Sarbanes-Oxley Act to the list of required exhibits to be included in reports filed with the Commission.

Under the final rules, the specific form and content of the Section 302 certification will be set forth in the applicable exhibit filing requirements for a company's periodic reports.

The amendments will permit companies to "furnish" rather than "file" the Section 906 certifications with the Commission. Thus, the certifications will not be subject to liability under Section 18 of the Exchange Act.

Moreover, the certifications will not be subject to automatic incorporation by reference into a company's Securities Act registration statements, which are subject to liability under Section 11 of the Securities Act, unless the issuer takes steps to include the certifications in a registration statement.

For More Information

Once final rules are made available in their entirety, BKD can help you interpret them and help advise on strategies for their implementation. In the meantime, contact your BKD advisor for further guidance about these issues.

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