

CORPORATE GOVERNANCE INITIATIVES

PRESIDENT BUSH SIGNED THE SARBANES-OXLEY ACT INTO LAW IN JULY, WITH FAR-REACHING REFORMS OF US BUSINESS PRACTICES. THIS NOTE FROM **BT GROUP LEGAL** SUMMARISES THE MORE IMPORTANT PROVISIONS FOR FOREIGN ISSUERS.

The Sarbanes-Oxley Act of 30 July applies to foreign issuers such as BT Group plc, whose shares are registered with the Securities and Exchange Commission (SEC), and BT plc whose bonds are also registered. The reason for extending it to foreign issuers was due to one of the chief authors of the Act, Senator Paul Sarbanes, who believed that there was a danger that US companies would relocate abroad to avoid its provisions. It is not always clear how the Act's provisions will apply to foreign issuers.

Many of the provisions of the Act will have to be implemented by rules to be made by the SEC and the Public Company Accounting Oversight Board (Board).

I - PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

Section 101 – Establishes the Board to oversee the audit of public companies that are subject to US securities laws.

Section 102 – Audit firms must be registered with the Board to prepare or issue an audit report.

Section 103 – The Board must establish rules for auditing standards, quality control standards and ethics standards to be used by auditors in the preparation and issue of audit reports.

Section 104 – The Board will conduct a continuing program of inspections to assess the degree of compliance of auditors with the Act and the rules of the Board and SEC. Annual inspections will be conducted of each audit firm that regularly provides audit reports for more than 100 companies.

Section 105 – The Board will establish rules for the investigation and disciplining of audit firms.

Section 109 – The budget of the Board will be payable from annual accounting support fees. The amount of fees payable will be based on the average monthly equity market capitalisation of a company for the 12 month period immediately preceding the beginning of the year to which the budget relates.

II – AUDITOR INDEPENDENCE

Section 201 – An audit firm may only provide any non-audit services, including tax services, if the Audit Committee approves in advance. But the audit firm must not provide the following services:

- bookkeeping or other services related to the accounting records or financial statements;
- financial information systems design and implementation;
- appraisal or valuation services;
- actuarial services;
- internal audit outsourcing services;
- management functions or human resources;
- investment adviser or investment banking services;
- expert services unrelated to the audit; and
- any other service that the Board determines is not permitted.

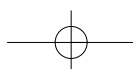
Section 202 – Auditing services provided to a company by the auditor must be approved in advance by the Audit Committee.

Section 203 – An audit firm must not provide audit services to a company if the audit partner responsible for reviewing the audit has performed audit services for that company in each of the previous five fiscal years. This means that the audit partner must be changed every five years.

Section 206 – An audit firm must not perform any audit service if the Chief Executive Officer or Chief Financial Officer was employed by that audit firm and participated in any capacity in the audit of the company during the one year period preceding the date of the audit.

III – CORPORATE RESPONSIBILITY

Section 301 – Every member of the Audit Committee must be a member of the company's board of directors and must be independent. In order to be considered independent, a member of an Audit Committee may not, other than in his capacity as a member



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of the Audit Committee, the company's board, or any other board committee, accept any consulting, advisory or other compensatory fee from the Company, or be an affiliated person of the company. Each Audit Committee must establish procedures for the treatment of complaints regarding accounting or auditing matters, and anonymous submissions by employees of concerns regarding questionable accounting or auditing matters. Payment of compensation to the audit firm must be determined by the Audit Committee.

Section 302 – The principal executive officer and the principal financial officer must certify in each annual or quarterly report filed that:

- the officer has reviewed the report;
- based on the officer's knowledge, the report does not contain any untrue statement of a material fact or omit to state a material fact;
- the report fairly presents in all material respects the financial condition and results of operations of the company;
- the signing officers are responsible for establishing and maintaining internal controls, have designed such internal controls to ensure that material information is made known to them by others, have evaluated the effectiveness of the company's financial controls and have presented in the report their conclusions about the effectiveness of their internal controls; and
- the signing officers have disclosed to the auditors and the Audit Committee all deficiencies in the design or operation of internal controls and any fraud.

Section 303 – An officer or director of a company must not take any action to mislead any auditor engaged in the performance of an audit.

Section 304 – If a company is required to prepare an accounting restatement due to the material non-compliance of the company with any financial reporting requirement, the Chief Executive Officer and the Chief Financial Officer must reimburse the company for any bonus or other incentive based compensation received by that person during the 12 month period following the first publication of the financial document, and any profits realised from the sale of securities of the Company during the 12-month period.

Section 306 – A director or executive officer must not purchase or sell any shares during any Blackout Period. "Blackout Period" means any period of more than three consecutive business days during which the ability of not fewer than 50% of the participants under all "Individual Account Plans" to purchase or sell any shares is temporarily suspended by the company. For the purposes of the section the term "Individual Account Plan" is defined in accordance with the US Employee Retirement Income Security Act 1974 and it seems unlikely that this section applies to foreign issuers. Blackout periods have to be notified by the Company to the director or officer and the SEC.

IV – ENHANCED FINANCIAL DISCLOSURES

Section 401 – Every financial report that contains financial statements must reflect all material correcting adjustments that have been identified by the auditor. Every annual and quarterly financial report must disclose all material off-balance sheet transactions. Pro-forma financial information included in any report

must not contain an untrue statement of material fact or omit to state a material fact, and reconcile the report with the financial condition and results of operations of the Company.

Section 402 – A company must not maintain credit in the form of a personal loan for a director or executive officer. However, a change from the Senate Bill dated 15 July is that personal loans by the Company in existence on the date that the Act is passed are not subject to the provisions of the Section, provided that there has been no material modification of any of its terms.

Section 404 – Every annual report must contain an internal control report which must state the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting, and contain an assessment of the effectiveness of those controls and procedures. Every audit firm that prepares an audit report must report on the assessment made by the management.

Section 406 – A company and its periodic reports must disclose whether or not (and if not, the reason why) the Company has adopted a Code of Ethics for senior financial officers. The term "Code of Ethics" means such standards as are reasonably necessary to promote honest and ethical conduct, and full, fair, accurate, timely and understandable disclosure in the periodic reports.

Section 407 – A company and its periodic reports must disclose whether or not (and if not, the reason why) the Audit Committee is comprised of at least one member who is a financial expert.

Section 408 – The SEC must review disclosures made by companies on a regular and systematic basis for the protection of investors. For the purposes of the timing of the reviews, the SEC must consider, among other factors, companies that experience significant volatility in their share price and issuers with the largest market capitalisation. A company must be reviewed at least once every three years.

Section 409 – A company must disclose on a rapid and current basis such additional information concerning material changes in the financial condition or operations of the issuer as the SEC determines is necessary or useful for the protection of investors and in the public interest.

VII – STUDIES AND REPORTS

Section 701 – The Comptroller General of the US must conduct a study to identify the factors that have led to the consolidation of accounting firms since 1989, the present and future impact of this and solutions to any problems identified, including ways to increase competition.

Section 702 – The SEC must conduct a study of the role and function of credit rating agencies.

Section 704 – The SEC must review and analyse all enforcement actions involving violation of reporting requirements to identify areas of reporting that are most susceptible to fraud, inappropriate manipulation or inappropriate earnings management.

Section 705 – The Comptroller General must conduct a study on whether investment banks and financial advisers assisted public

companies in manipulating their earnings and obfuscating their true financial condition.

VIII – CORPORATE AND CRIMINAL FRAUD ACCOUNTABILITY

Section 806 – It will be an offence to knowingly alter, destroy, conceal or falsify any record, document or object with the intent of impeding or influencing the investigation or proper administration of any matter within the jurisdiction of any department or agency of the US. Offences are punishable by a fine or imprisonment for a term of not more than twenty years, or both. Any accountant who conducts an audit must maintain all audit or review work papers for a period of five years.

Section 806 – No company or any officer, employee or contractor may discharge, demote, suspend, threaten, harass or in any other manner discriminate against an employee because of any lawful act done by the employee to assist in an investigation regarding any conduct which the employee reasonably believes constitutes a violation of any rule or regulation of the SEC.

Section 807 – It is an offence for anybody to attempt to execute a scheme to defraud any person in connection with any security, or to obtain by means of false or fraudulent pretences, representations, or promises, any money or property in connection with the purchase or sale of any security. Offences may be punishable by fine or imprisonment for a term of not more than twenty-five years, or both.

IX – WHITE COLLAR CRIME PENALTY ENHANCEMENTS

Section 906 – Each periodic report containing financial statements must be accompanied by a written statement by the Chief Executive Officer and the Chief Financial Officer. The statement must certify that the information contained in the periodic report fairly presents, in all material respects, the financial condition and results of operations of the issuer. Any person who wilfully certifies any statement knowing that the periodic report accompanying the statement does not conform with the requirement of the Section can be fined not more than \$5m or imprisoned for not more than twenty years, or both.

Section 1105 – The SEC may issue an order prohibiting any person from acting as an officer or director of the company if their conduct demonstrates unfitness to serve.

Section 1107 – Any person who knowingly, with the intent to retaliate, takes any action harmful to any person, for providing to a law enforcement officer any truthful information relating to the possible commission of any Federal offence, is liable to a fine or imprisonment for not more than ten years, or both.

This briefing has been prepared by the BT Group Legal department.

Please note that it is a summary of the more important provisions of the legislation and is not intended as a detailed guide or interpretation, in particular as the Act applies to foreign issuers. Readers must take their own independent professional advice before taking any action.

For details of the ACT Workshop on this topic please contact Makayla Rahman on 020 7213 0703 or email mrahman@treasurers.co.uk