

The Cascading Effects of Sarbanes-Oxley

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Introduction

- Sarbanes-Oxley Act Purpose and Summary
- Forecast of Effect on Private Companies
- Effect on Private Companies and Non-Profits Today
- Effect on International Offices
- Section 404
- Conclusion



Purpose of Sarbanes - Oxley

- Reforms to address scandals
- Protect investors in public companies
- Restore investor confidence in markets
- Provide oversight of accounting industry
- Encourage compliance and internal controls
- Discourage corporate wrongdoing



2



Summary of Sarbanes-Oxley

- CEO and CFO must certify financial statements
- Increases criminal penalties
- Expedited SEC filings
- Bans certain executive compensation practices
- Board and committee composition requirements
- Protection for whistleblowers



3



Sarbanes – Oxley and Private Companies: The Fallout

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May 15, 2003*



4



Effect on Private Companies

More Disclosure

More Transparency

More Accountability

- To Shareholders

- To Lenders

- To Those With Whom You Do Business



5



Effect on Private Companies

- New standards for best practices
- Standards required by:
 - Shareholders, venture capital firms and private equity investors
 - Lenders
 - Vendors, customers, suppliers
 - Judges and **juries**



6

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Benefits of Compliance

- Happier shareholders
- Investors/Lenders/Acquirers/Insurance Companies are more comfortable with companies that have sound corporate governance practices
- Improved due diligence review
- Reduced litigation exposure
- Easier to close a deal, grow or obtain financing



7

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Benefits of Compliance (Cont.)

- Increased availability of D&O insurance
- Increased ability to attract board members
- Avoid perception of insider dealings
- Corporate culture that is good for growth
- Positive community image



8



Effect on Non-Profits

- New standards for best practices
- Standards required by:
 - Board Members
 - Donors
 - Community



9



Take Aways -- Mandatory

- Adopt Document Destruction and Records Retention Policy
- **Adopt Internal Complaint Policy and Procedures**
- Provide Notice of Blackout Periods for Contribution Plans (if applicable)
- Review D&O Insurance Policy (read the fine print)



10



Take Aways -- Recommended

- **Adopt Code of Conduct and Ethics**
- **Recruit Independent Directors**
- Implement Director Education Program
- Discontinue Personal Loans to Officers and Directors
- **Negotiate Insider Transactions at Arm's Length**
- Monitor "Piggyback" Legislation by States



11



Take Aways -- Recommended

- Adopt Audit Committee Charter
- Reconstitute Audit Committee
- **Have Auditors Report to Audit Committee**
- **Phase Out Certain Non-Audit Services Provided by Auditors**
- **Pre-Approve Allowed Non-Audit Services**
- Require Certification of Financial Statements



12



Take Aways -- Recommended

- Review Internal Accounting Controls Adequacy and Scope
- Implement Updated Internal Accounting Controls
- Implement Follow-up Procedures for Auditor Recommendations
- **Include MD&A With Financial Statements**
- **Follow and Adopt Escalating Accounting Standards**



13



Effect on Acquisitions

- Acquisition of a Private Company by a Public Company
 - Due diligence
 - Purchase agreement
 - Post-closing integration
 - Public disclosure following the acquisition



14

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Effect on Pre-IPO Companies

- Assist Private Company in IPO Process of Becoming a Public Company
 - Will have to Comply Once Public
 - Avoid Bottleneck
 - NYSE / NASDAQ Rules



15

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What's Happening Today?



16



Effect on Private Companies and Non-Profits Today

2005 National Directors Institute Survey

- 9,000 CEOs, CFOs, GCs, CCOs, Board Members
- 68 Surveys Returned
- 87% Private Companies Felt Impact
- 78% Self-imposed Corporate Governance Reforms



17



Effect on Private Companies and Non-Profits Today

Groups Causing Adoption of Corporate Governance Reforms

- Auditors – 35%
- Customers – 22%
- Lenders – 18%
- Insurance Companies – 18%
- Investors – 6%



18



Effect on Private Companies and Non-Profits Today

Groups Causing Adoption of Corporate Governance Reforms

- Board Members – 52%
 - Non-Profits – 69%
 - For-Profit – 39%



19



Reforms Adopted by Private Companies and Non-Profits

- Audited Financial Statements – 97%
- Code of Ethics – 94%
- Disclosure of Accounting Policies – 88%
- Disclosure of Off-Balance Sheet and Contingent Liabilities – 81%
- Board Approval of Auditor Services – 75%



20



Reforms Adopted by Private Companies

- Establishment of Independent Directors – 72%
- Audit Committee Oversight of Auditors – 64%
- Whistle-blower Procedures – 64%
- Independent Director Approval of Related-party Transactions – 49%
- Restricting Executive Compensation – 38%



21



Reforms Adopted by Non-Profits

- Establishment of Independent Directors – 90%
- Audit Committee Oversight of Auditors – 97%
- Whistle-blower Procedures – 83%
- Independent Director Approval of Related-party Transactions – 69%
- Restricting Executive Compensation – 59%



22



Effect on International Offices

- “North American Phenomenon”
- Carnero v. Boston Scientific Corp. – SOX not Apply Extraterritorially
- Code of Conduct
 - Rare outside U.S. and Canada
 - Strong Employee Privacy Rights Outside U.S.
 - Don’t Force U.S. Policies on Uniform Basis



23



Effect on International Offices

- Whistleblower Compliance
 - Reporting on Co-workers Seen as Disloyal and Suspect
 - Reporting Requirements and Anonymous Hotlines Contrary to EU Data Privacy Rules
 - Whistleblower Protections must be Consistent with Local Laws and Reflected in Code of Conduct



24



Section 404 Internal Controls

- SEC Advisory Committee on Smaller Public Companies
 - Recommending SEC Grant Exemption to Smaller Private Companies – *404 Lite*
 - Currently July 2007 Implementation Deadline
 - Meet with Support and Dissent
- DT and KPMG – Adopt Standards Tailored for Smaller Private Companies



25



Conclusions

- No Silver Bullet or Cookie Cutter Programs
 - For Profit v. Non-Profit
 - Company Size
 - IPO Destiny
 - International Offices
- There are Benefits
 - Measure Against Costs



26



Questions?

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27

