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MEMORANDUM

June 19, 2003

To Our Clients and Friends

Re: SEC's Final Rule On Management's Report
on Internal Control Over Financial Reporting

To implement Section 404 of the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley"), the Securities and Exchange Commission ("SEC") has issued a final rule requiring companies subject to the reporting requirements of the Securities and Exchange Act of 1934 to include in their annual reports a report of management on the company's internal control over financial reporting.¹ The SEC is also requiring management to evaluate any change that occurs during a fiscal quarter that affects, or is reasonably likely to materially affect, a company's internal control over financial reporting. In addition, the SEC is amending the certification requirements of Section 302 of Sarbanes-Oxley. The final rule is effective August 14, 2003.

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

A company's annual report is to include an internal control report of management that contains:

- A statement of management's responsibility for establishing and maintaining adequate internal control over financial reporting for the company;
- A statement identifying the framework used by management to conduct the evaluation² of the effectiveness of the company's internal control over financial reporting;

¹ Registered investment companies and asset-backed issuers are exempt from this requirement.

² While the final rule does not specify the method or procedures to be performed in an evaluation, the SEC expects such evaluation to be supported by evidential matter, including documentation, regarding both the design of internal controls and the testing processes. This evidential matter should provide reasonable support: for the evaluation of whether the control is designed to prevent or detect material misstatements or omission; for the conclusion that the tests were appropriately planned and performed; and that the results of the tests were appropriately considered.

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- Management’s assessment of the effectiveness of the company’s internal control over financial reporting as of the end of the company’s most recent fiscal year, including a statement as to whether or not the company’s internal control over financial reporting is effective.
 - The assessment must include disclosure of any “material weaknesses” in the company’s internal control over financial reporting identified by management.
 - Management is not permitted to conclude that the company’s internal control over financial reporting is effective if there are one or more material weaknesses in the company’s internal control over financial reporting; and
- A statement that the registered public accounting firm that audited the financial statements included in the annual report has issued an attestation report on management’s assessment of the company’s internal control over financial reporting. A copy of this attestation report must be filed as part of the company’s annual report.

Compliance dates vary depending upon whether a company is an “accelerated filer.”

Bank and thrift holding companies that are subject to this requirement concerning internal control over financial reporting and which prepare internal control reports under Section 36 of the Federal Deposit Insurance Act can prepare two separate management reports to satisfy the FDIC’s and the SEC’s requirements or can prepare a single management report that satisfies both the SEC’s and FDIC’s requirements.

CHANGES IN INTERNAL CONTROLS DURING A FISCAL QUARTER

The final rule stipulates that a company’s management is to evaluate and disclose in its quarterly report (or in its annual report in the case of the last quarter of a fiscal year) any change in the company’s internal control over financial reporting that occurred during that fiscal quarter that has materially affected, or is reasonably likely to materially affect, the company’s internal control over financial reporting.

CERTIFICATION REQUIREMENTS

The final rule revises the Section 302 certification requirements and requires companies to provide the certifications required by Sections 302 and 906 of Sarbanes-Oxley as exhibits to certain periodic reports. The rule also changes the date for evaluation and disclosure of a company’s disclosure controls and

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procedures to the end of the period covered by an annual or quarterly report, rather than as of a date within 90 days of the filing date of the quarterly or annual report.

A company must comply with these revised certification requirements in reports due on or after August 14, 2003 although it may eliminate references in the certifications to internal control over financial reporting until such time as it is required to comply with internal control requirements.

DEFINITION

The final rule defines “internal control over financial reporting” as:

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 reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those 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 that receipts and expenditures of the registrant are being made only in accordance with authorizations of management and directors of the registrant; and
- Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the registrants’ assets that could have a material effect on the financial statements.

The final rule can found at www.schwartzandballen.com/WhatsNew.htm.

If you have any questions concerning the final rule, please call Gilbert Schwartz, Robert Ballen or Tom Fox at (202) 776-0700.