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Learn about this important act's impact on public companies, private firms, and non-profits via this 2-part series by consultant and friend Barbara Kravitz.

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Workplace Ethics

Levels of ethical misconduct in the workplace are still prevalent despite a rise in ethics-based programming.

According to the 2005 National Business Ethics Survey (NBES) released by the *Ethics Resource Center*, more than half of American workers have observed at least one type of ethical misconduct in the workplace, representing a slight increase from 2003.

Employee reporting of misconduct they observe is also down by 10%.

Despite the decrease in ethical conduct, according to the report, "Ethics and compliance programs can and do make a difference. However, their impact is related to the culture in which they are situated."

The survey of more than 3,000 American workers analyzes trends in workplace ethics, the implementation of formal programs, the ethical culture within organizations, the impact of programs, and factors that pose risks of misconduct.

Some key findings include:

- 52% of employees observed at least one type of misconduct in the workplace in the past year; 36% of these observed 2 or more
- 69% of employees report their organizations implement ethics training, up 14% from 2003
- 65% indicated their organizations have a place for ethics advice
- 55% of those who observed misconduct reported it, down 10% from 2003

A critical finding is the importance of an ethical culture in organizations; the informal social system that sets norms for behavior and tells employees how things really work in that organization.

For more information, please visit www.ethics.org.

Sarbanes-Oxley

BEST PRACTICES, INTEGRATED FINANCIAL CONTROLS

By Barbara K. Kravitz

The Sarbanes-Oxley Act of July 2002 (SOx) has changed the corporate governance environment and put the ethical spotlight on the executive suite and board members. While SOx is focused on public companies, heads-up private firms and not-for-profit entities are taking this opportunity to significantly improve their ethics and governance practices.

The purpose of the act is "to protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to securities laws, and for other purposes". The legislation is Congress' action to prevent a recurrence of fraudulent transactions and questionable accounting evidenced by the Enron-era scandals.

Overall, SOx imposes comprehensive accounting, governance and compliance

frameworks for public companies and non-US public multi-national companies doing business in the United States.

However, in a cascading effect, the SOx 404 standards for internal financial controls as applied by auditors throughout the public company sector are substantially impacting private companies as well as not-for profit entities. In effect, SOx is becoming the due diligence standard for IPO, bank and venture financing transactions.

The Act is comprised of 11 Titles focused on audit standards, integrated financial controls and documentation, transparent reporting, ethical conduct, and audit oversight. SOx places responsibility for accuracy in documentation and submission of financial reporting squarely on the shoulders of CEOs and CFOs who are required to certify in SEC filings that they have designed and implemented adequate financial control systems.

Additionally, these principal officers must cite the presence (or absence) of material deficiencies in their internal controls which can result in the withholding of a "clean" auditor's letter or require financial restatements. CEOs and CFOs are subject to fines and/or up to 20 years in prison for certain SOx violations.

In September 2005 a joint meeting of the Advisory Committee on Smaller Public Companies and the SEC Government-Business Forum on Small Business Capital Formation (Forum), whose annual mandate is to identify barriers to capital raising and recommend changes, took place in San Francisco. Representatives of several accelerated filers testified about soaring costs due primarily to aggressive auditor testing, IT

infrastructure changes, and dedicated staff time. Other witnesses commended SOx for clarifying governance practice and making financial reporting more consistent and transparent.

Following the Joint Session the SEC voted to grant a further extension until July 15, 2007 of the smaller public company filing date for meeting SOx 404 financial reporting requirements.

SOx HIGHLIGHTS

[Provisions of the Act are subject to continuing SEC interpretation and related rule-making.]

Section 302 - CEOs and CFOs must certify they have designed and maintained internal controls ensuring that material information is available and have identified for the auditors all significant deficiencies, material weaknesses or fraud that could adversely affect financial reporting. Additionally, they must certify they have reviewed all financial reports and that they fairly present financial conditions and contain no misrepresentations. Deficiencies or material changes in internal controls must be reported to audit committees.

Section 304 - In the event restatements are required, the Act provides for reimbursement by the CEO or CFO of bonus or incentive compensation, or profits from the sale of the company's stock received during the previous 12 months.

Section 306 - The Act makes the Board Audit Committee directly responsible for the "appointment, compensation and oversight of the work of any registered public accounting firm". Audit committee members must be "independent", receiving no fees for consulting or advisory work or from an affiliated person of the issuer or any subsidiary.

Section 402 - Prohibits personal loans or credit to a director or officer

Section 404 - Annual reports must contain an "internal control report" stating management is responsible for establishing and maintaining an adequate internal control structure and reporting system, assessing its effectiveness and related procedures. The Company's external auditors

must attest to and report on management's "assessment of the effectiveness of internal controls".

Section 406 - The SEC is to issue "code of ethics" rules for senior financial officers which are defined as reasonably necessary to promote honest and ethical conduct, including actual or apparent conflicts of interest between personal and professional relationships, full fair and accurate disclosure in periodic reports, and compliance with applicable governmental rules and regulations.

Section 407 - At least one member of the audit committee is a financial expert understanding GAAP principles and their application for estimates, accruals and reserves, having experience in internal accounting controls and an understanding of audit functions. CEO's and/or CFOs must evaluate material violations.

Section 409 - Public companies are expected to report disclosure on a rapid and concurrent basis (48 hours) of additional material changes in financial condition or operation.

Section 802 - Criminal penalties for destruction, alteration or falsification of records in Federal investigations and bankruptcy are subject to fines, up to 20 years imprisonment or both. Accountants must maintain work papers for 5 years from the end of the audited fiscal period.

Section 806 - Whistle-blower protection makes it illegal to discharge, demote, suspend, threaten, harass or in any manner discriminate against an employee ...for providing information or assisting in an investigation of conduct believed to violate Federal statutes.

Section 807 - A fine or imprisonment of up to 25 years can be imposed for defrauding any person in connection with securities or obtaining money or property or promises thereof in connection with the purchase or sale of any security.

Section 902 - Corrupting, altering, destroying or mutilating documents with the attempt to impair their integrity or availability is a crime.

Section 1102 - Tampering with, destroying or mutilating documents with intent to impair their integrity or availability for use in official proceedings is subject to fines or imprisonment of up to 20 years.

Section 1105 - The Commission can prohibit temporarily or permanently a person from serving as an officer or director.

Certain penalties under certain sections of the Securities & Exchange Act of 1934 are lifted from \$2,500,000 to up to \$25,000,000.

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Words from the Wise

We all know that culture is not what we say, but what we do. But at times the *spoken word* is worth repeating:



"Courage is being scared to death but saddling up anyway." — John Wayne

"If humanity is to survive and avoid new catastrophes, then the global political order must be accompanied by sincere and mutual respect among the various spheres of civilization, culture, nations, or continents, and by honest efforts on their parts to seek and find the values or basic moral imperatives they have in common."

—Va'clav Havel

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