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HRO Alert
The Sarbanes-Oxley Act of 2002

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SARBANES-OXLEY DISCLOSURE CONTROLS AND PROCEDURES

REQUIRED CERTIFICATIONS

On August 29, 2002, the SEC adopted rules requiring certifications by principal executive and financial officers of public companies as to the accuracy and completeness of their periodic reports, including annual and quarterly reports filed on Forms 10-K, 10-KSB (applicable to small business issuers), 10-Q and 10-QSB, comparable foreign issuer Forms 20-F and 40-F, and amendments to these forms. New rules also require certifications as to the company's disclosure controls and procedures. Adoption of the certification rules was required by Section 302 of the Sarbanes-Oxley Act of 2002 (the "Act").

Specifically, with respect to their company's disclosure controls and procedures, the officers must certify that they:

- are responsible for establishing and maintaining disclosure controls and procedures for the company;
• have designed the disclosure controls and procedures to ensure that material information relating to the company and its consolidated subsidiaries is made known to the signing officers, particularly during the period for which the periodic reports are being prepared;
• have evaluated the effectiveness of the company's disclosure controls and procedures as of a date within 90 days before filing the report; and
• have presented in the report their conclusions about the effectiveness of the company's disclosure controls and procedures based upon their evaluation as of that date.

DISCLOSURE CONTROLS AND PROCEDURES

The certification rules require that companies establish “**disclosure controls and procedures**” that are designed to ensure that information required to be disclosed in the reports filed under the Securities Exchange Act of 1934 (the “**Exchange Act**”) (including quarterly, annual and current reports, definitive proxy materials and information statements, and amendments to these reports or documents) is recorded, processed, summarized and reported within the specified time periods. The SEC did not specify the form that the disclosure controls and procedures should take or how those controls should be evaluated. Instead, each company is expected to design a program that is tailored to its business and management.

In the release announcing the adoption of the new rules, the SEC noted that a public company that does not have flawed disclosure could still be subject to SEC action for violation of the rules if it fails to maintain adequate disclosure controls and procedures. This underscores the importance that the SEC places on the process that companies follow concerning their public disclosures.

This memorandum is intended to assist you and your company in establishing, maintaining and evaluating disclosure controls and procedures. Although no single set of disclosure controls and procedures is appropriate for every public company, the following general guidelines should assist your company in designing and implementing its disclosure controls and procedures:

- **Identify Current Processes.** Identify the controls and procedures that your company has in place for gathering information and preparing its periodic reports. Some of the controls and procedures may be formal, such as the preparation of director and officer questionnaires, and others may be informal and undocumented.
- **Assess Processes and Procedures.** Determine whether your current controls and procedures (1) adequately capture the information that is required in your company’s periodic reports and (2) enable the necessary information to be recorded, processed, summarized and reported on a timely basis.
- **Adopt Necessary Changes.** After identifying and assessing your current procedures, you should modify them to the extent necessary to comply with the new rules.
- **Record/Document.** Record in writing each control, procedure and process to be followed. For example, you should prepare timetables and checklists, identify responsible parties and necessary qualifications for reviewers, and create simple, unambiguous instructions to be followed. These processes should be realistic and achievable. Your company must follow them.
- **Regularly Evaluate Procedures.** Regularly re-evaluate the effectiveness of your company’s disclosure controls and procedures. They must evolve with your business. As your company grows and its filings become more complex, its controls and procedures should become more formalized and structured.
- **Follow Your Procedures.** In many instances it is worse to have policies and not follow them, than it is to not have any policies at all. Accordingly, you should create a system that complies with the rules, but is workable for your organization.

DISCLOSURE COMMITTEE

Because your company's principal executive officer and principal financial officer must certify as to the disclosure controls and procedures, the SEC has recommended—but not required—that public companies form a committee (a "**Disclosure Committee**") responsible for reviewing and evaluating the company's disclosure in periodic reports and communications with its stockholders. The following questions and answers may be helpful in designing your disclosure controls and procedures.

Q. Why should we have a Disclosure Committee if it is not required by the SEC?

- A. The SEC's suggestion that all public companies establish a committee that reviews company disclosure is, in most cases, sufficient reason to have a Disclosure Committee. There are other reasons why establishing a Disclosure Committee is a good idea, including:
- **Perspective.** A committee comprised of employees in different departments brings a broader perspective and base of information to the disclosure process than would a committee of legal and financial people.
 - **Consistency and Continuity.** Having a Disclosure Committee helps to insure consistency and continuity in your company's disclosure process even if the company experiences personnel turnover.
 - **Group Analysis.** A Disclosure Committee is more likely than an individual to thoroughly analyze difficult disclosure questions. Generally, concerns about negative repercussions over unpopular disclosure positions are less for a group charged with information gathering and disclosure preparation than for a single individual.
 - **D&O Insurance.** In connection with the renewal of D&O insurance policies, insurers are reviewing the compliance processes of their insureds. Having a Disclosure Committee will be viewed favorably by insurers.

Q: How should the Disclosure Committee be formed?

- A. We recommend that the membership of the Disclosure Committee and the Disclosure Committee's charter be approved by your company's CEO and CFO and ratified by its Audit Committee. See **Exhibit A** for a sample Disclosure Committee charter. Upon formation, the Disclosure Committee should establish a set of written disclosure controls and procedures.

Q: Who should serve on the Disclosure Committee?

- A. The SEC suggests that the Disclosure Committee could include the principal accounting officer (or controller), the general counsel or other senior legal official with responsibility for disclosure matters, the principal risk management officer, the chief investor relations officer (or an officer with equivalent responsibilities) and other officers (such as business unit heads) as the company deems appropriate. You should evaluate your own circumstances and may consider including on your company's Disclosure Committee the treasurer and representatives from internal audit, marketing, human resources and information technology.

The Disclosure Committee should have a chair and vice chair. The chair should be a member of senior management, perhaps the CFO or general counsel.

Disclosure Committee members should be familiar with SEC rules and, collectively, be well informed about all significant aspects of the company's business, finances and prospects (including risks). Continuing education about SEC reporting and disclosure practices should be available to members of the Disclosure Committee.

Q: *To whom should the Disclosure Committee report?*

- A. The SEC suggests that the Disclosure Committee report to senior management, including the principal executive and financial officers who are responsible for designing, establishing, maintaining, reviewing and evaluating the company's disclosure controls and procedures.

Q: *What disclosures should the Disclosure Committee review?*

- A. The Disclosure Committee should review all SEC filings, your company's website, all press releases disclosing financial information, guidance and material information (such as significant acquisitions or the sale of a business unit), other information broadly disseminated to stockholders, and presentations to analysts or investor conferences.

Q: *What if the Disclosure Committee cannot meet and there is a filing or press release that must be reviewed?*

- A. Disclosure controls and procedures should allow for situations when the entire Disclosure Committee cannot meet. We suggest that your disclosure controls and procedures provide that specified disclosures (e.g. filings that must occur quickly, press releases and information posted to the company's website relating to non-sensitive matters), can be reviewed and approved by your company's CEO and CFO on behalf of the Disclosure Committee. Periodic reports and current reports filed on Form 8-K regarding important matters should be subject to the more formal process.

ASSEMBLING THE DISCLOSURE TEAM

We recommend that your company's Disclosure Committee form a team to assist in disclosure preparation. The three phases of the recommended process are: (1) identifying and gathering relevant information, (2) analyzing what information should be disclosed and preparing the relevant periodic and other reports, and (3) regularly evaluating the effectiveness of disclosure controls and procedures in practice. The process and staffing are typically pyramidal, with a larger group gathering a broad array of information that a smaller group will analyze and refine in preparing a company's disclosure. The work of these two groups (membership of which may overlap) as well as the disclosure controls and procedures must be evaluated, at least quarterly, by senior management.

Q: *Who should participate in the disclosure process?*

- A. An outline that describes the types of information that should be disclosed in your periodic reports is attached as **Exhibit B**. You should determine who is best able within your company to gather and analyze that information. **Exhibit B** provides examples of people and departments that should be involved in various aspects of the disclosure process. Also, attached as **Exhibit C** is a proposed timeline for completing tasks in the preparation of your periodic reports.

We suggest that the disclosure team include representatives from the following departments or groups of your company:

- accounting and treasury group,
- internal audit,
- each major operating group or business line,
- risk management, if applicable,
- human resources,
- corporate secretary,
- investor relations,
- legal, and
- others as necessary.

Q. Aside from our independent auditors, to what extent should we involve outside advisors, such as legal counsel, in our disclosure process?

- A. Legal counsel and other advisors can provide valuable insight in analyzing disclosure obligations and crafting accurate, understandable disclosure. They often have a better perspective as a result of their distance from the company. Having worked with a range of clients, outside counsel can bring varied experience in helping clients implement “best practices” with their disclosure controls and procedures. An independent perspective on disclosure practice is always useful in evaluating your disclosure controls and procedures.

If outside counsel has direct information, such as on a litigation matter or a transaction or agreement, they can provide valuable assistance in analyzing and preparing information for disclosure. However, having outside counsel review periodic reports cannot absolve your company or its certifying officers of ultimate responsibility for its disclosure.

You should determine whether any material disclosure should be reviewed and validated by an independent industry expert. For example, should an outside expert update mineral reserve estimates or the estimated cost of recovery of minerals? Should an outside engineer review cost estimates of an environmental clean up or regulatory compliance?

Q. How involved in the disclosure process should our CEO and CFO be?

- A. The Act and rules require your principal executive officer and principal financial officer to certify not only the content of your periodic reports, but that they are “responsible for establishing and maintaining disclosure controls and procedures.” They must also certify that they have “evaluated the effectiveness” of these controls and procedures and present in the report their conclusions as to the “effectiveness” of the controls and procedures. These certifications set the minimum involvement of these officers in the disclosure process.

Q. *When should we involve our audit committee?*

- A. Section 302 of the Act expressly requires your principal executive officer and principal financial officer to certify that they have disclosed to your auditors and audit committee all significant deficiencies in the “internal controls which could adversely affect [your] ability to record, process, summarize, and report financial data,” and “any fraud, whether or not material,” involving management or other employees that have a significant role in the company’s internal controls. This certification both acknowledges the active role of the audit committee in a public company, and establishes an affirmative duty (the failure of which can easily be verified) on the part of the certifying officers to report deficiencies and instances of fraud directly to the audit committee.

As a result of these new rules, you should re-examine the role that your audit committee plays in the disclosure process. While a Disclosure Committee can oversee and safeguard the procedural aspects of your disclosure process, the audit committee oversees and safeguards the substantive aspects of your disclosure process. In order to create disclosure controls and procedures that both comply with the statute and are efficient for the company, you should actively engage your audit committee in the process from the onset.

You may want to consider having your certifying officers and outside auditors, as appropriate, meet with the audit committee to review the disclosure document, to review the procedures that were followed in connection with the relevant disclosures, and to discuss any issues that have arisen during the process that relate to the company’s internal controls or procedures. Your certifying officers should then discuss with the audit committee the specific certifications identified above and demonstrate adequate understanding of the certifications and satisfaction with the procedures followed during the disclosure process.

Q. *Our financial statements comply with GAAP—isn’t that all that is required for financial statements?*

- A. GAAP is not a safe harbor! The SEC pointedly noted that the certification statement by the CEO and CFO is “not limited to a representation that the financial statements and other financial information have been presented in accordance with ‘generally accepted accounting principles’ and is not otherwise limited by reference to generally accepted accounting principles.” The SEC went on to say that it believes that Congress sought assurance in the certification that financial information discussed in SEC filings “meets a standard of overall material accuracy and completeness that is broader than financial reporting requirements under generally accepted accounting principles.” The Commission concluded: “In our view, a ‘fair presentation’ of an issuer’s financial condition, results of operations and cash flows encompasses the selection of appropriate accounting policies, proper application of appropriate accounting policies, disclosure of financial information that is informative and reasonably reflects the underlying transactions and events and the inclusion of any additional disclosure necessary to provide investors with a material, accurate and complete picture of an issuer’s financial condition, results of operations and cash flows.”

INSTILLING PERSONAL RESPONSIBILITY IN THE TEAM

The quality of your periodic reports and other filings with the SEC, as well as the other public disclosure you make, depends upon establishing a corporate culture that encourages full and fair disclosure and upon the rigor and conscientiousness of each person involved in each phase of the disclosure gathering and preparation process. The quality of the disclosure is only as strong as

the weakest link in the disclosure team. The certification requirements imposed by the Act have undoubtedly made the CEO and CFO acutely aware of their personal responsibility in the disclosure process. Generally, the teams charged with analysis and preparation of the disclosure and evaluation of the process are also committed to the careful execution of their responsibilities in the disclosure process.

Q. What are common deficiencies you see in the disclosure process?

- A. Some of the most common mistakes we see in the disclosure process include the following:
- Focusing too much on gathering detailed information, and not enough on spotting important, overarching trends and fundamental changes in the company's business (i.e. "missing the forest for the trees").
 - Following too closely the disclosure filed last year or last quarter rather than taking a fresh look at the company and its industry in the current environment.
 - Reading instructions too narrowly. We recommend that you seek guidance from counsel or another advisor if you have doubts as to the applicability of disclosure requirements.
 - Attempting to limit disclosure to the minimum acceptable level. We recommend that the Disclosure Committee encourage all of the members of the disclosure preparation team to think critically about what constitutes full and fair disclosure, as opposed to focusing on "what is the bare minimum we can disclose."

Q. Should we require backup certificates from individuals who prepare information that is included in our periodic reports?

- A. Many companies require certificates from individuals who supplied information for the periodic reports, or who are the head of the business unit or department responsible for such information, as support for the CEO and CFO certifications. If you follow this practice, it should be followed consistently from period to period with a consistent scope of certification provided. Sample certifications for Disclosure Committee members and others who assist in the disclosure process (but are not members of the Disclosure Committee) are attached as **Exhibits D** and **E**, respectively.

ROLE OF INITIAL DRAFTERS AND REVIEWERS

To assure the accuracy and completeness of your company's periodic reports, we suggest that the Disclosure Committee assign individual responsibility for preparing and reviewing specific portions of the periodic reports. The Disclosure Committee can delegate the initial drafting duties to two or three individuals—perhaps one person with a financial background, one person with a legal background and one business person. These initial drafters would be responsible for meeting with and interviewing employees of the company that have been identified as having the most relevant and current information on the topics for which the initial drafter is preparing disclosure (e.g. in preparing the "Business" section, the initial drafter may interview the heads of the company's business divisions, or, in preparing the executive compensation disclosure, the initial drafter may interview the vice president of human resources). For a more detailed analysis regarding the delegation of drafting and reviewing responsibilities, see attached **Exhibit B**.

The initial drafters' drafts should then be provided to everyone that the initial drafters interviewed. These initial reviewers would evaluate the draft for accuracy and completeness, making any revisions

necessary to include all material information. After the initial review is complete, the disclosure, along with any supporting documentation, should be forwarded to the individual responsible for incorporating all of the various disclosure pieces into a single document. This document should then be provided to the Disclosure Committee for final review.

Q. *What should we provide to our initial drafters and reviewers to assist with the preparation of their sections of the periodic report?*

- A. We suggest that you give each initial drafter written instructions similar to those attached as **Exhibit F-1**, and that you give each initial reviewer written instructions similar to those attached as **Exhibit F-2**. We also suggest that each initial drafter and reviewer receive (1) a copy of the Item or Items of Regulation S-K that specifies the information that should be included in their section or sections, (2) a copy of the last annual or quarterly report filed by the Company with the SEC, as applicable, (3) sample disclosure from the filings of peer companies, and (4) any additional information that the company considers relevant to the section or sections being prepared. It is important to tell initial drafters and reviewers that items (2) and (3) were provided for their convenience as samples of prior disclosure. The initial drafters should not simply replicate the disclosure contained in a previous filing of the company or that contained in the filing of a peer company—in fact, they should be discouraged from doing so.

If your company decides to obtain the certifications discussed under the heading “Instituting Personal Responsibility In The Team,” in connection with the preparation of your annual report and in addition to the documents listed above, you should also provide each initial drafter and reviewer with a backup certificate relating to involvement in the drafting process, a sample of which is attached as **Exhibit E**. Initial drafters and reviewers should be instructed to complete and sign the backup certificate and return it with the rest of their materials.

Q. *What information should the Disclosure Committee obtain from the initial drafters and reviewers in addition to draft disclosure?*

- A. You should instruct the initial drafters, prior to the interview portion of the disclosure process, to obtain from the persons that they interview supporting documentation for any information to be included in the disclosure that is not derived from the your company’s financial reporting package. This supporting documentation should then be forwarded to the Disclosure Committee along with the initial draft of the disclosure. This will allow the Disclosure Committee to verify the accuracy of the information included within the disclosure without conducting additional research.

Q. *How will initial drafters or reviewers know whether certain information is material to the company as a whole?*

- A. They may not. For example, if the company asks the head of a division to assist in the preparation of the “Business” section of the periodic report, there may be circumstances that are material to the interviewee’s division but not the company as a whole. Accordingly, we suggest that you instruct initial drafters who are responsible for preparing disclosure for a particular division or unit to ask the employees that they interview about information that is material to their particular division or unit. After the initial drafter elicits the relevant information, he or she can make a determination as to materiality to the company. You should encourage the initial drafters to confer with the Disclosure Committee as to any questions of materiality.

Q. Should our initial drafters and reviewers be responsible for assisting the Company in its current reporting obligations on Form 8-K?

- A. The proposed list of events that trigger an 8-K filing is extensive – it would be easy to miss an event that should be reported. We suggest that everyone in management be made aware of the events that trigger the 8-K filing requirement, and be instructed to contact a person appointed by the Disclosure Committee immediately upon learning that such an event has occurred or is likely to occur. The importance of immediately notifying the appropriate person of an 8-K trigger event should be stressed to management, as the SEC has proposed to reduce the 8-K filing deadline to two business days following the occurrence of the trigger event.

DETERMINING THE EFFECTIVENESS OF THE DISCLOSURE CONTROLS AND PROCEDURES

Once the disclosure controls and procedures have been put in place, the principal executive officer and principal financial officer must certify that they have evaluated these procedures. The evaluation must be completed within 90 days prior to each annual and quarterly report filed with the SEC. Their conclusions regarding the effectiveness of the disclosure controls and procedures must be included in each report.

Q. What is the purpose of the evaluation?

- A. The purpose of the evaluation is to (1) review the disclosure controls and procedures, (2) confirm that the company has properly implemented the disclosure controls and procedures, (3) confirm that the disclosure controls and procedures are adequate to ensure that material information is made known to the CEO and CFO, and (4) confirm that the disclosure controls and procedures ensure that the information contained in the company's Exchange Act filings and other public statements accurately reflects the condition of the company and are made in a timely manner.

Q. How do we evaluate our disclosure controls and procedures?

- A. As with the design of the disclosure controls and procedures, there is no one size fits all solution. The evaluation process will depend to a large extent on the individual circumstances of the company, and its reporting, management and supervisory structure. However, you should consider the following in designing your company's evaluation process:
- Design a formal evaluation process. It is important to have a written evaluation process, including designating the people responsible for conducting the evaluation and the steps to be taken. In planning the process for each Exchange Act filing, identify those areas of disclosure which are at the time the most sensitive and warrant particular attention.
 - Ensure that the employees conducting the evaluation are familiar with the disclosure controls and procedures.
 - Evaluate whether the current disclosure controls and procedures are sufficient for the company's business. This evaluation should take into account any changes in the company's business or management and supervisory structure, including significant acquisitions or dispositions, changes in personnel, regulatory developments and changes in industry practice.

- Determine whether the disclosure controls and procedures are being followed. There is a significant difference between whether the disclosure controls and procedures are being followed and whether they would be effective if followed. Once the disclosure controls and procedures are established, it is extremely important that they be followed.
- Test whether the disclosure controls and procedures are effective with interviews and document review. Interview individuals involved in the disclosure process, internal auditors and external auditors. Back-up materials providing the basis for disclosure should be reviewed periodically.

Q: *We have finished our evaluation, now what?*

A: To the extent your evaluation of the disclosure controls and procedures has revealed deficiencies, the controls should be revised. The development of the disclosure controls and procedures is an ongoing process and must be adapted to meet the changing environment in which your company operates.

Q: *Do our quarterly evaluations need to be as thorough as our annual evaluations?*

A: There is no basis in the Act or SEC regulations for treating an evaluation for quarterly reports on Form 10-Q any differently than an evaluation in connection with an annual report on Form 10-K. However, it is reasonable to assume that you need only evaluate the disclosure controls and procedures relating to the information included in the relevant report.

Q: *What do we include in the Exchange Act filings about the results of the evaluation?*

A: SEC regulations require that the company include the CEO's and CFO's conclusions about the effectiveness of the disclosure controls and procedures in each periodic report. There is no guidance as to what information is required in this presentation. Presumably, as companies receive SEC comments on these presentations, it will become clearer as to what constitutes meaningful disclosure regarding these conclusions. At a minimum, we suggest that the presentation include a summary of the evaluation process, the conclusions regarding the effectiveness of the disclosure controls, and any corrective steps to be taken. The rules specifically require that the report disclose any significant changes in the internal controls made subsequent to the evaluation date.

Q: *Do we need to evaluate our internal controls as well?*

A: The SEC draws a distinction between "internal controls" that are designed to ensure accurate reporting of financial information and "disclosure controls and procedures" that are designed to ensure the accuracy of all information necessary to prepare the periodic reports. Internal controls are a subset of disclosure controls and procedures. An evaluation of the disclosure controls and procedures should include an evaluation of the internal controls.

You should note, however, that in addition to the certifications described above relating to disclosure controls and procedures, the new rules require your principal executive officer and principal financial officer to certify that they have disclosed any "significant deficiencies" in the internal controls to the company's auditors and audit committee.

HOW HRO CAN HELP

The Act initiated sweeping changes to the disclosure and reporting system for public companies in the United States. Recent SEC regulations have helped to better define the new requirements, and additional rules will follow in the upcoming months. The new rules will prompt significant changes in the way many public companies collect, record, process, summarize and report information. We expect that participants in the preparation and review of periodic SEC filings, particularly those whose roles in the process will be expanded under the new rules, will have many questions about designing and implementing a system of disclosure controls and procedures that is right for their company. If you would like to discuss any of the issues related to disclosure controls and procedures and how they will impact your company and its practices, we encourage you to contact any of the persons listed in the margin of the first page of this memorandum.

This memorandum does not address all of the provisions of the new rules and regulations relating to disclosure controls and procedures, and is not intended to address specific securities law compliance and disclosure issues that may arise in particular circumstances; nor does it constitute legal advice with respect to any specific situation. Clients in need of such advice are encouraged to contact any of the attorneys listed in the margin of the first page of this memorandum.