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***An Employer's Sarbanes - Oxley Checklist***

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October 1, 2002

Section 402 of the recently passed Sarbanes-Oxley accounting reform and corporate accountability act prevents publicly traded companies from directly or indirectly making personal loans to executive officers. (For a general discussion, see the link at Sarbanes-Oxley Act of 2002 and Relocation). The seemingly simple language of §402 turns out to very complex, because currently it is not clear how comprehensively the regulators and courts will interpret it. The incentive for getting it right is that this is a criminal statute with high visibility.

Because of the uncertainty of the reach of the section, different interpretations will undoubtedly be made, until the Securities and Exchange Commission (SEC) or the courts give guidance. In the meantime, employers and relocation management companies need to get on with relocating employees, including executive officers. As of the end of September, 2002, while there has been no official interpretation of the law by the SEC, there are certain trends in interpretation which are useful to study in context; these are noted below.

**However, this checklist does not constitute legal advice, and every company regulated by the Act should consult counsel before making any decisions regarding relocation programs affecting executive officers.**

The key to a safe and successful move of an executive officer is communication, starting with the corporate relocation director and corporate staff. Here is a suggested interim checklist of issues and actions which should be considered.

- Contact should be made NOW with a client's in-house corporate counsel to determine:
  - Whether the company is covered by the Sarbanes – Oxley Act (the "Act"). If not, this needs to be documented by a legal opinion to protect the corporate officers and service providers from possible criminal liability. However, if the company is not covered, then the remainder of this checklist need not be followed.
  - Whether counsel is aware of the potential application of §402 to relocations, and that loans -- whether called loans or not -- are a routine part of relocations. If not, be sure that the relocation policy and practices are carefully examined by counsel (see the discussion of "loans" and "executive officers" below).
  - Whether counsel has determined coverage of "executive officers" for the other purposes in the Act. If so, the need for consistency will probably require that this definition be used for relocation purposes.
  - Whether the company is a bank or other lending institution which may provide the types of loans specifically allowed by §402.
- Contact should be made NOW with any relocation management companies

("RMC") which may be providing parts or all of the relocation process to determine:

- How a system of communication and procedures can be set up to make sure that the requirements of the Act are met.
  - How the employer can certify, in advance, that an employee is, or is not, an executive officer.
    - Since this designation should be determined in consultation with in-house counsel, the criteria used should be communicated and agreed to by the RMC.
  - Whether the RMC has instituted procedures for handling employees identified as executive officers, so that illegal loans are not inadvertently made to them.
    - These procedures need to be shared with, and agreed upon, by all parties involved.
- Special consideration needs to be given to the following relocation practices:
- The definition of "executive officers". As mentioned previously, in many cases corporate counsel will have determined this for other purposes of the Act. If not, a careful, reasoned, analysis must be made. In general, while the most conservative approach would probably be to use the definition found in 17 CFR (paraphrased in the link at Sarbanes-Oxley Act of 2002 and Relocation), many securities lawyers now believe that the legislation will be deemed to apply only to those executive officers who are required to be named in the company's filings with the SEC (for example in the 10-K). In the case of independent operating units or subsidiaries where there is no such reporting requirement, a reasoned determination need be made by counsel and documented.
  - The identification of "credit in the form of personal loans"; which are prohibited acts if made, directly or indirectly, to executive officers. It is imperative that the relocation department, in-house counsel, and the RMC (if used), understand and determine what are to be considered personal loans, so that they will not be offered to executive officers.
    - As a matter of common sense, any money given to a relocating employee which has a repayment obligation should be considered a "personal loan" unless counsel agrees otherwise.
    - Likewise, any money advanced to a relocating employee which requires the signing of a promissory note should be considered a loan.
    - Many standard relocation practices, while not called loans, may be loans for the purpose of the Act. Unfortunately, until courts or regulators give us guidance, we are not certain how far the prohibition will reach. For example:
      - Pre-contract loans are probably prohibited, because they are loans evidenced by a note or other repayment obligation.
      - Post-contract loans are not so easy. Bridge loans are most probably loans. However, equity advances are unclear, if they are not evidenced by a note (e.g., for Federal tax purposes, advances are not considered loans). The most conservative approach would be to consider these loans where there is any possibility of the requirement of repayment, such as, in a fall through where the purchaser does not purchase the employee's house, for any reason. Although generally interest free to the employee, the employer is charged interest from the date the funds are issued until repayment is made (whether in the form of proceeds from the sale of the home or through reimbursement by the employer). Many securities lawyers now believe that the analysis used for the IRS should also apply for the purposes of the Act. Thus, a contractual equity advance not evidenced by a note or other repayment obligation, would not be considered an improper "personal loan".
      - Mortgage assistance (including direct billing) and buy downs are also not clear.

- Repayment agreements, where the employee is obligated to repay part of the relocation cost if he or she does not continue in the employment of the company for a period of time, have been mentioned by some as resembling a loan. Again, there is no law on this issue, and considering this a loan would be a conservative position. Some securities lawyers are of the opinion that a repayment agreement represents an absolute grant from the company to the employee, subject to a condition subsequent, which would likely not constitute a personal loan for the purposes of the Act.
- Credit cards issued to the employee for the purpose of paying relocation expenses where some expenses may not be paid by the company may be a prohibited form of credit to the extent that the amounts charged are not fully reimbursable by the company under the terms of the relocation policy. Debit cards used solely for the convenience of payment are much less problematical.
- Relocation departments and RMCs should immediately:
  - Review in-place relocations to make certain that no improper loan is inadvertently made.
  - Work to devise temporary "work-arounds" to make certain that employers are still able to relocate executive officers without violating the Act. It was not the intention of the Act to keep companies from relocating their executive officers.

ERC will continue to update its information and guidance on this subject as the implications of the Act, and decisions concerning it, are forthcoming. In the meantime, employers and RMCs need to keep open communication regarding proper procedures.

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