

Client Alert: SEC Proposes Certification of Disclosure in Companies' Annual and Quarterly SEC Reports

A. Introduction

On June 17, 2002, the SEC published for comment proposed rules that would require a company's principal executive officer and principal financial officer to certify that, to their knowledge, the information in the company's quarterly and annual reports filed with the SEC is true in all important respects, and that the reports contain all information about the company of which they are aware that they believe is important to a reasonable investor.¹ Furthermore, the rules propose that companies be required to maintain procedures to provide reasonable assurances that the company is able to collect, process and disclose the information required in the company's quarterly and annual reports, as well as in current reports on Form 8-K. Companies also would be required under the proposed rules to implement a system by which these procedures are periodically reviewed and evaluated.

B. Certification of Disclosure

The rules propose to add an explicit certification requirement in connection with the filing of quarterly reports on Form 10-Q and annual reports on Form 10-K pursuant to the Exchange Act. Under the proposal, a company's principal executive officer and principal financial officer each would be required to certify in an annual report on Form 10-K that:

- he or she has read the report;
- to his or her knowledge, the information in the report is true in all important respects as of the end of the period covered by the report; and
- the report contains all information about the company of which he or she is aware that he or she believes is important to a reasonable investor as of the end of the period covered by the report.

The proposed certification would also contain a statement explaining that information would be "important to a reasonable investor" if:

¹ See Securities and Exchange Commission Release No. 34-46079; File No. S7-21-02. A copy of the Release is available on the SEC website at: <http://www.sec.gov/rules/proposed/34-46079.htm>

- there is a substantial likelihood that a reasonable investor would view the information as significantly altering the total mix of information in the report; and
- the report would be misleading to a reasonable investor if the information was omitted from the report.

The certification in a quarterly report on Form 10-Q would be substantially similar, but would take into account the narrower disclosure required in quarterly reports.

The proposed certification would not alter the current signature requirements for annual or quarterly reports.

In its proposing release, the SEC stated that it does not believe the proposed certification requirement would “create an unacceptable risk of increased liability” for a company’s principal executive officer and principal financial officer, noting that the proposed certification is subjective in nature in that it is limited to an officer's knowledge and belief. However, the SEC also noted that a principal executive officer or principal financial officer providing a false certification potentially could be subject to an SEC action for violating Section 13(a) of the Exchange Act and to both SEC and private actions for violating Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

C. Internal Controls and Procedures

The proposed rules would require every company subject to the reporting requirements of Section 13(a) or 15(d) of the Exchange Act to:

- maintain sufficient procedures to provide reasonable assurance that the company is able to collect, process and disclose, within the time periods specified in the SEC’s rules and forms, the information, including non-financial information, required to be disclosed in its periodic and current reports filed pursuant to the Exchange Act; and

- each year, before the filing of its annual report on Form 10-K or 10-KSB:
 - conduct an evaluation of the effectiveness of the design and operation of these procedures under the supervision of company management; and
 - ensure that those conducting the evaluation communicate the results of the evaluation to the company's principal executive officer and principal financial officer and board of directors.

The SEC has noted that in carrying out their responsibilities to provide accurate and complete information to security holders, it is necessary for companies to ensure that their internal communications and other procedures operate so that important information flows to the appropriate collection and disclosure points in a timely manner. Currently, reporting companies are required to establish and maintain systems of internal procedures and controls with respect to their financial information. The proposed rules would complement the existing regime and are intended to ensure that a company maintains commensurate procedures for gathering, analyzing and disclosing all information that is required to be included in its periodic and current reports.

The SEC further recommends that each company create a committee, reporting to senior management, with responsibility for considering the materiality of information and determining disclosure obligations on a timely basis. The SEC notes that officers and employees of the company who have an interest in and the expertise to serve on the committee could include the principal accounting officer or the controller, the general counsel or other senior legal official, the principal risk management officer, the chief investor relations officer, and such other officers or employees as the company deems appropriate.²

² In addition to the SEC's proposed rules, a committee of the New York Stock Exchange has recently recommended amendments to the NYSE's listing standards which, among other things, would require the chief executive officer of each listed company to certify each year that the company has established procedures for verifying the accuracy and completeness of the information provided to investors; that those procedures have been carried out; and that, based on his or her assessment of the adequacy of those procedures and of the diligence of those carrying them out, he or she has no reasonable cause to believe that the information provided to investors is not accurate and complete in all material respects. The chief executive officer would further be required to certify that he or she has reviewed with the board those procedures and the company's compliance with them. See Report of the NYSE Corporate Accountability and Listing Standards Committee (June 6, 2002), at 23, available at <http://www.nyse.com>.

Comments Sought

The staff of the SEC invites interested persons to submit written comments on the proposed amendments and any other matters that might have an impact on the proposed amendments. Comments should be received on or before August 19, 2002. Comments may be submitted electronically at the following e-mail address: rule-comments@sec.gov. All comment letters should refer to File No. S7-21-02; this file number should be included in the subject line if e-mail is used.

CHADBOURNE & PARKE LLP

For Additional Information

If you have any questions regarding the proposed rules, please contact:

Peter R. Kolyer
(212) 408-5564
pkolyer@chadbourne.com

Marc A. Alpert
(212) 408-5491
malpert@chadbourne.com

Sey-Hyo Lee
(212) 408-5122
shlee@chadbourne.com

Ven Medabalmi
(212) 408-1056
vmedabalmi@chadbourne.com

Chadbourne & Parke LLP

New York
30 Rockefeller Plaza
New York, New York 10112
Telephone (212) 408-5100
Facsimile (212) 541-5369

Washington
1200 New Hampshire Avenue N.W.
Washington, D.C. 20036
Telephone (202) 974-5600
Facsimile (202) 974-5602

Los Angeles
350 South Grand Ave, Suite 3300
Los Angeles, CA 90071
Telephone (213) 892-1000
Facsimile (213) 622-9865

Hong Kong
Suite 2203, Tower 1
Lippo Centre, 89 Queensway
Hong Kong
Telephone: (852) 2842-5400
Facsimile: (852) 2521-7257

Moscow
53/5 Kosmodamianskaya Naberezhnaya
Moscow, Russian Federation 115054
Telephone: (7-095) 974-2424
Facsimile: (7-095) 974-2425

London
Chadbourne & Parke (a multinational partnership)
Regis House
45 King William Street
London EC4R 9 AN
Telephone: (44-20) 7337-8000
Facsimile: (44-20) 7337-8001

If you would like additional copies of this client alert, please contact Doreen Norden, Director of Marketing and Creative Services, at (212) 408-5190 or e-mail: dnorden@chadbourne.com