

Client Alert

A report
for clients
and friends
of the firm July 2002

The SEC Has Proposed to Require CEOs and CFOs to Certify the Annual and Quarterly Reports That Their Companies File With the SEC.

Summary

On June 17, in Securities Exchange Act of 1934 Release No. 46709 (the "Proposing Release"), the Securities and Exchange Commission proposed to require that principal executive officers (CEOs) and principal financial officers (CFOs) certify to the disclosures in their companies' annual and quarterly reports filed with the SEC. The SEC also proposed that companies be required to maintain procedures to provide reasonable assurances that they are able to collect, process and disclose the information required in their annual, quarterly and current reports filed with the Commission. Companies would be required to periodically review and evaluate these procedures. The CEO, CFO and the board of directors would be required to review the results of this evaluation, and the CEO and the CFO must certify in their company's annual report that they have done so.

These proposals would not apply to foreign companies, although the SEC has asked for comment as to whether they should apply.

These proposals are part of President Bush's 10-point program for improving investor confidence in our capital markets after Enron. A special committee of the New York Stock Exchange has recommended a similar but somewhat broader certification requirement and some in Congress are considering legislation that would require these certifications. Accordingly, the chances are good for these proposals being adopted some time fairly soon after the comment period expires on August 19th of this year.

The Certification Proposals

The proposed certifications by CEOs and CFOs would require annual reports on Forms 10-K and 10K-SB and in quarterly reports on forms 10-Q and 10Q-SB. Each would provide a separate certification.

Annual Reports

The certifications would be required to contain the following:

- A statement of the officer certifying that he or she has read the [specify the report in which the certification is included];
- A statement of the officer certifying that to his or her knowledge, the information in the report is true in all important respects as of the last day of the period covered by the report;
- In annual reports only, a statement of the officer certifying that the report contains all information about the issuer of which he or she is aware that he or she believes is important to a reasonable investor as of the last day of the period covered by the report;
- A statement that, for purposes of the certification, information is "important to a reasonable investor" if:
 1. 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
 2. The report would be misleading to a reasonable investor if the information was omitted from the report. Note: There is no materiality limitation.

In addition, in annual reports, CEOs and CFOs would be required to provide the certification discussed below under "The Periodic Review Proposals — Certification."

Quarterly Reports

The certification in a quarterly report would be essentially the same as that in a report except that in quarterly reports, a statement would be required of the officer certifying that the report contains all information about the issuer of which he or she is aware, or believes is important to a reasonable investor, in light of the subjects required to be addressed in the report, as of the last day of the period covered by the report.

The Periodic Review Proposals

Companies would be required to maintain sufficient procedures to provide reasonable assurances that they are able to collect, process and disclose, within the

time periods specified in the SEC's rules and forms, the information required to be disclosed in the periodic and current reports filed by them under the Exchange Act.

Within the 12-month period immediately preceding the filing of each annual report, an evaluation would be required to be carried out, under the supervision of the company's management, of the effectiveness of the design and operation of the procedures. Without limiting the subjects that the evaluation would be required to cover, at a minimum the evaluation would be required to identify any material weakness in the procedures, any other deficiency that would significantly adversely affect the company's ability to collect, process or disclose required information on a timely basis and any material changes in these internal procedures and controls, including any corrective actions that have been or are being taken with regard to identified weaknesses and deficiencies.

Before the filing of the annual report, each CEO and CFO and the Board of Directors of the company would be required to review the results of the evaluation.

The SEC would not mandate any particular procedures, but it does recommend that companies create committees reporting to the CEO and CFO, with the responsibility for considering the materiality of information and determining disclosure obligations on a timely basis. The SEC suggests that the committee could include:

- the principal accounting officer or the controller;
- the general counsel or other senior legal official with responsibility for disclosure matters who reports to the general counsel;
- the principal risk management officer;
- the chief investor relations officer (or an officer with equivalent responsibilities); and
- other officers or employees, including individuals associated with company's business units, as the company deems appropriate.

Certification

The certification included in each annual report would be required to contain a statement that each officer signing this certification has reviewed the results of the required evaluation of the issuer's internal reporting procedures.

This would cover not only procedures for annual and quarterly reporting, but also for current reporting on Form 8-K. The SEC has proposed extensive revisions to the timing and content of these current reports, which have been (see Securities Act of 1933 Release No. 8090 (April 12, 2002) reports of insider transactions) or will be the subject of a separate alert (see Securities

Act of 1934 Release No. 8106 (June 18, 2002) reporting of specified material events).

Liability Considerations

The SEC states, in the Proposing Release, that it does not believe that the proposed certifications would create "any untoward risk of increased individual liability for certifying officers." However, it is difficult to predict how courts would apply these requirements.

Duty of Inquiry

The SEC states in the Proposing Release that the certifying officers "would not, as the result of the proposed certification requirement, have to separately inquire as to information not known to him or her by virtue of his or her certification" However, the SEC also states "while these corporate officers would not have to undertake a separate inquiry as to information not known to them, their critical review of a report would necessarily include other inquiries where appropriate, including, without limitation, regarding disclosures they do not understand or the materiality of information known to them."

Hopefully, if the SEC adopts these proposals, it will provide clearer guidance as to the duty of inquiry of the certifying officers.

Conclusion

Since it is likely that these proposals will be adopted, companies should begin the process of reviewing their reporting procedures in order to have procedures in place to comply with the new rules by the fourth quarter of this year or the first quarter of 2003.

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Client Alert

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