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Client Alert

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SEC Orders Corporate Officers of Large Public Companies to Certify Certain Company Filings Under Oath

CEOs And CFOs Of Public Companies Should Act Now To Prepare To Certify Concerning The Completeness And Accuracy Of Their Companies[1] Periodic Reports Filed With The SEC

In our April 2002 Client Alert we advised that the collapse of the Enron Corporation likely would lead to new oversight, investigation, and reporting obligations for corporate boards and officers. The expected process had been going forward with, *inter alia*, the SEC proposing new rules. However, subsequent events, including the recent announcement by WorldCom of a $3.8 billion restatement of its financial results, have led the SEC to take immediate action. On June 27, 2002, the SEC issued an order which (1) recited that the Commission had commenced an investigation concerning "reports of accounting irregularities at public companies, including some large and seemingly well-regarded companies" and (2) directed the CEOs and CFOs of the country's largest companies (947 in number, each with revenues greater than $1.2 billion during their last fiscal year) to file certifications, in writing and under oath, as to the content of their companies' last Annual Report on Form 10-K, all subsequent quarterly reports and certain other SEC filings. These certifications, which will be made public by the SEC, are due at the time of filing of a company's first annual or quarerly report on or after August 14, 2002.

While the focus of this alert is on the June 27 order directed to the CEOs and CFOs of the nation's largest companies, given the pendency of proposed rules intended to reach **all** public companies[1] and the enhanced scrutiny to which all reporting companies will be subjected as a consequence of recent events, the corporate boards and officers of all public companies should seriously consider implementing the procedures and policies discussed below.

The SEC's Order[2]

The chief executive officer and the chief financial officer of each of the 947 companies identified by the SEC must separately state in writing and under oath in the form prescribed by the SEC (Exhibit A to its order) that to the best of his or her knowledge none of the reports identified by the SEC contains an untrue statement of material fact or omits to state a material fact necessary to make the statements in the report not misleading. Alternatively, if the CFO and/or CEO cannot so swear, he or she is required to file a written statement, again under oath, describing the facts and circumstances that would make such an averment of completeness and accuracy incorrect. In both instances, the swearing officer must state whether he or she has reviewed his or her own statement with the company's audit committee.

The reports enumerated by the SEC which must be accompanied by the sworn officer statement (referred to as "covered reports" in the order) specifically include definitive proxy materials, as well as annual reports on Form 10-K, reports on Form 10-Q and reports on Form 8-K, as well as any amendments to those reports and materials on file with the SEC.

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1 On June 17, 2002, the SEC published for public comment proposed rules that would require the principal executive officer and principal financial officer of every company that files annual and quarterly reports with the SEC to certify that he or she has read the report; that to his or her knowledge, the information in the report is true; and that the report contains all the information about the company of which he or she is aware that he or she believes is important to a reasonable investor. See Proskauer Rose LLP Client Alert entitled "The SEC Has Proposed to Require CEOs and CFOs to Certify the Annual and Quarterly Reports That Their Companies File With the SEC."

2 There are experienced securities lawyers who believe that the SEC may have exceeded its authority in issuing this order. However, given the public outcry and response to recent revelations of financial statement irregularities, it is not likely that any CFO or CEO will step forward to challenge the order; nor is it clear, in today's environment, that such a challenge, if made, would be successful.

The deadline for complying with the SEC's order is the first date that the officer's company would be required to file a Form 10-K or Form 10-Q with the SEC on or after August 14, 2002. If the company secures an extension of the due date of its report pursuant to SEC Rule 12b-25, the date for compliance with the order will similarly be extended. Certifications may not be filed through the EDGAR system. Rather, they must be delivered to the Secretary of the SEC. Further, in commentary to its order the SEC has advised corporate officers that they must take "sufficient steps to assure" that the Commission's Secretary actually receives their sworn written statements. Finally, the SEC has specifically stated that such statements will be made public.

It is plainly intended that the order be retrospective, that is, a chief financial officer and a chief executive officer either must state under oath that the company's Annual Report, already on file with the SEC, as well as all 8-Q and 10-K reports and proxy materials filed thereafter (and any amendments to these reports or materials), are accurate and complete or disclose under oath those facts and circumstances that would make such an avowal of completeness and accuracy incorrect. That these sworn statements will be carefully reviewed by the SEC has been underscored by SEC Chairman Harvey Pitt. Thus, for example, on July 14, 2002, Mr. Pitt described the Commission's on-going investigation and said that when the sworn statements covered by its recent order are filed, the SEC will have a better gauge of problems "lurking out there."

Consequence of Failure to Comply

A failure to comply with the June 27 order could take one of three forms: (1) failure to file the ordered statement; (2) filing of a false statement that the company's covered reports are complete and accurate; (3) filing of a false or misleading statement to explain why the averment that the covered report is complete and accurate could not be provided.

Because orders like the one just promulgated by the SEC are relatively rare and untested, the consequences of a failure to comply are uncertain. However, a CEO or CFO who fails to comply or who files an inaccurate statement would risk the consequences discussed below.

A. Failure to File

The SEC could seek a court order to enforce its June 27 order. Further, in all likelihood, the SEC would order a formal investigation of the delinquent CEO's or CFO's company.

B. False Statement of Accuracy and Completeness

A false statement of accuracy and completeness could result in:

- Criminal penalties for the making of a false statement to a government agency or making fraudulent statements publicly. Penalties could include incarceration and substantial fines.
- An SEC application to a court to bar the CEO or CFO who filed a false statement from serving as an officer or director of a public company.
- A court imposed injunction requiring compliance and barring future violations.
- Civil penalties of up to $100,000 per violation.
- Liability for damages in private shareholder and other actions.

C. The Filing of a Statement Containing False or Misleading Explanations

The filing of a false or misleading statement to explain why an averment of accuracy and completeness could not be filed would have the same consequences as the filing of a false statement of accuracy.

Recommended Steps To Prepare To Give The Required Statement

The SEC's June 27 order compels the CEOs and CFOs of the affected companies to simultaneously consider the accuracy and completeness of company Annual Reports, subsequent reports and proxy materials already on file with the SEC and quarterly reports in preparation for filing in mid-August.

It is undoubtedly the case that the great majority of the CEOs and CFOs of the companies covered by the SEC's June 27 order took appropriate steps to satisfy themselves with respect to the completeness and accuracy of their companies' Annual Reports and other SEC filings. Nonetheless, they should consider engaging in further due diligence before submitting a sworn written statement to the SEC, particularly if any subsequent event could affect the accuracy or completeness of the filed reports. At a minimum, they should carefully re-read the reports and be certain that they understand the company selection and implementation of significant and critical accounting policies and practices. If they have any questions, they should consult with the company's auditors (internal and/or outside). Further, they should again satisfy themselves that the company's internal controls were reported to have been operating effectively and that they are aware of no indications to the contrary.

Additionally, they should review any correspondence received from the SEC relating to any of the filed covered reports and all responses by the company. They should also review all communications between the company and its independent auditors during the periods encompassed by the filed covered reports, including management letters and any communications relating to the internal controls over financial reporting.

If there has been a change in auditors since any of the covered reports were filed, the new auditors should be consulted with respect to their views concerning the accounting principles and practices applied to the financial statements in the covered reports. Finally, the CEO and the CFO should report the results of their review of the company's filed reports to the audit com-

mittee and discuss with the committee the statements they intend to file with the SEC.[3]

Because the sworn statement is due at the time most companies will be filing their next reports on Form 10-Q, it also will be necessary for CEOs and CFOs of such companies to swear with respect to those reports. To further ensure the accuracy and completeness of those reports, companies should consider the creation, if it does not already exist, of a management committee, assisted by the company's independent accountants and lawyers, to review the draft report. Consideration should be given to including some or all of the following on such a committee:

- The company's principal accounting officer or controller
- The general counsel or other senior legal officer with responsibility for disclosure matters
- The company's principal risk management officer, if such a position exists at the company
- The officer principally responsible for investor relations

That committee should review the company's procedures for collecting, processing and disclosing the information required in the report.[4] In particular, the committee should focus on the efficacy of the company's internal controls over financial reporting and that such controls are operating effectively. In addition, the CFO and CEO, in conjunction with appropriate members of the committee, should consider following all of the steps referenced above in our discussion of company reports already on file with the SEC. Further, the CFO and CEO should review all board of directors and board committee minutes for the periods encompassed by the report. In addition, the CEO and CFO should satisfy themselves that there is appropriate consistency between the reports already on file with the SEC and the report now in preparation. All inconsistencies should be investigated. If there has been a change in auditors since the covered Annual Report, consideration also should be given to whether a re-audit by the new auditors is necessary.

Additional Points to Consider

Although the SEC's order explicitly places responsibility for the sworn statements on each of a company's CEO and CFO, those individuals must inevitably rely on others, particularly given the enormous size and complexity of the companies that are subject to the SEC's June 27 order. Each CEO and CFO therefore must additionally satisfy himself or herself that confidence in subordinates is justified. The level of their own review and the extent to which they involve outside accountants, lawyers, and other professional advisors may depend on their level of confidence in those subordinates. Given the necessary reliance on, and involvement of, others in management in preparing to make the required sworn statements, the SEC's June 27 order therefore may have the effect — hopefully salutary — of causing re-evaluation of the company's key personnel.

No CEO or CFO should ever accept or approve anything he or she does not understand. If the CEO or CFO is presented with information that is not clear or well understood, he or she should seek clarification and explanation. If necessary, outside professional advice should be obtained.

On all occasions, the CEO and CFO each should report the results of his or her review to the audit committee and discuss with the committee the sworn written statement he or she plans to submit to the SEC.

Finally, each CEO and CFO should review statutory indemnification provisions and comparable provisions in the company's certificate of incorporation and by-laws as well as all similar contractual arrangements and the company's directors' and officers' liability insurance to determine whether and to what extent appropriate protections are available with respect to the statements the CEO and CFO now are required to provide to the SEC.

3 Some have suggested that there be a "SWAT team" approach to these reviews. In such an approach, the company would engage outside counsel who in turn would engage forensic accountants to do an in-depth review of the covered reports and the company's procedures and internal controls over financial reporting. Each company must determine whether its own particular situation warrants such an approach.

4 In this regard we note that the SEC's proposed new Exchange Rule 13a-15 would require companies to maintain procedures to provide reasonable assurance that the company is able to collect, process and disclose such information.

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