

Client Alert

A report
for clients
and friends
of the firm June 2003

The SEC Has Adopted Rules Requiring an Annual Report by Management Regarding Internal Control Over Financial Reporting

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On May 27, 2003, the Securities and Exchange Commission adopted rules to implement Sec. 404 of the Sarbanes-Oxley Act. See Rel.33-8238 (June 5, 2003) (the "Adopting Release"). The SEC also amended its rules requiring CEO and CFO certifications of annual and quarterly reports to better reflect their responsibilities with respect to internal control over financial reporting and to require filing of these certifications as exhibits to the reports that they certify¹.

Transition Periods

These rules, which apply to both domestic and foreign companies subject to requirements for filing periodic reports with the SEC, will become effective on "Compliance Dates" as follows:

- Domestic issuers that are "accelerated filers"² – management report on internal control over

financial reporting – reports for fiscal years ending on or after June 15, 2004;

- Domestic issuers – quarterly evaluations – first periodic report due after the first annual report required to include the new management report (not applicable to foreign private issuers);
- Foreign private issuers and domestic issuers that are not "accelerated filers" – management report on internal control over financial reporting – reports for fiscal years ending on or after April 15, 2005;
- Quarterly evaluations by non-accelerated filers – First periodic report due after the first annual report required to include the new management report (not applicable to foreign private issuers); and
- All "issuers," domestic and foreign private – revised CEO and CFO certification requirements, including exhibit filing requirements – August 14, 2003, with deferral with respect to certain internal control certifications.

Management Report on Internal Control Over Financial Reporting

The Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley") requires the SEC to adopt rules to provide for a management report on "internal control" and an auditor attestation on that report.

Sarbanes-Oxley Sec. 404 – Management Assessment of Internal Controls. Paragraph(a) of Sec. 404 requires the SEC to adopt rules to provide that each annual report required by section 13(a) or 15(d) of the Securities Exchange Act of 1934 (Forms 10-K, 10-KSB, 20-F and 40-F) contain an internal control report stating:

¹ Special provisions applicable to depository institutions, certain registered investment companies (Sec. 405 of the Sarbanes-Oxley Act exempts registered investment companies from Sec. 404) and issuers of asset-backed securities are not addressed in this client alert.

² Essentially, U.S. issuers that have over \$75 million in equity market capitalization. See Exchange Act Rule 12b-2.

- The responsibility of “management”³ for establishing and maintaining an adequate internal control structure and procedures for financial reporting; and
- Assessing, as of the end of the most recent fiscal year, the effectiveness of the internal control structure and procedures for financial reporting.

Sec. 404(b) of Sarbanes-Oxley requires the “registered public accounting firm”⁴ that issues the audit report to the company, as part of the audit engagement and not as a separate engagement, to attest to management’s assessment of the effectiveness of the internal controls and procedures for financial reporting in accordance with the rules of the PCAOB.

Sarbanes-Oxley did not impose any deadline on the required SEC rulemaking under Sec. 404, but audit firms may have up to 450 days after enactment of Sarbanes-Oxley on July 30, 2002, to register with the PCOAB.

SEC Rules – Item 308 of Regulations S-B and S-K, Item 15 of Form 20-F and General Instruction B to Form 40-F. The SEC’s rules go beyond the express requirements of Sec. 404, in that they require: (i) some quarterly updating reporting of certain material changes in “internal control over financial reporting,”⁵ not just an annual assessment of internal control over financial reporting (although only an annual management report on these controls and procedures is required); and (ii) the filing of the registered public accounting firm’s attestation to that annual assessment. The SEC’s action also required the amendments to the CEO and CFO certification

requirements, which are discussed below. The annual management report is in addition to the report on disclosure controls and procedures required by Item 307 of Regulations S-B and S-K and the corresponding requirements of Forms 20-F and 40-F.

The SEC’s rules make no exceptions for small business issuers or foreign private issuers, except as to the transition periods mentioned above.

The SEC has not specified the exact content of management’s report. However, its rules require that:

- The company’s annual report filed with the SEC include a report of its management that contains:
 - A statement of management’s responsibility for establishing and maintaining adequate internal control over financial reporting for the company⁶;
 - A statement identifying the framework used by management to evaluate the effectiveness of the registrant’s internal control over financial reporting as required by Rule 15(e) or 15d-15(c);
 - Management’s assessment of the effectiveness of the company’s internal control over financial reporting as of the end of the company’s most recent fiscal year;⁷ including a statement as to whether or not internal control over financial reporting is effective,⁸ including disclosure of any “material weakness”⁹ in the company’s internal control over financial reporting identified by management¹⁰ (Management is not

3 The term “management” is not defined in Sarbanes-Oxley or in the SEC’s rules. However, given the context and references to them in various of the new rules, “management” appears to be intended to include the issuer’s principal executives officer (“CEO”) and principal financial officers (“CFO”, “CAO” and Controller).

4 Title I of Sarbanes-Oxley provides a new regulatory structure for the accounting profession, including a requirement that independent auditors of SEC reporting companies register with the Public Company Accounting Oversight Board (“PCAOB”). The PCAOB has proposed that these registration requirements require domestic firms to be registered on or before October 22, 2003, and foreign firms to be registered on or before April 19, 2004.

5 The SEC chose this verbal formulation for its rules rather than the phrase “internal control structure and procedures for financial reporting” used in Sec. 404.

6 The SEC has indicated that this statement should not be interpreted to mean that management personally must conduct the necessary activities to evaluate the design and test the operating effectiveness of the company’s internal control over financial reporting. Activities, including those necessary to provide management with the information on which it bases its assessment, may be conducted by non-management personnel acting under the supervision of management. See Adopting Release, Footnote 78.

7 Under the SEC’s existing rules, an issuer’s principal executive officer (“CEO”) and principal financial officer (“CFO”) must certify, in the issuer’s annual and quarterly reports filed with the SEC, that they evaluated the effectiveness of the issuer’s disclosure controls and procedures as of a date within 90 days of the date of filing the report (the “Evaluation Date”). See Rule 13a-14(b)(4)(ii). The SEC has amended its certification rules to move the Evaluation Date to the end of the period covered by the report.

8 The SEC’s Rules do not require that the evaluation take place on the last day of the period, but that the statement of effectiveness of the company’s disclosure controls and the internal control over financial reporting is as of the end of the period.

9 For purposes of the SEC’s rules, the term “material weakness” has the same meaning as it is given under generally accepted auditing standards (“GAAS”). A “material weakness” is defined in Statement on Auditing Standards No. 60 (codified in Codification of Statements on Auditing Standards AU §325) as a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by errors or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. The term “significant deficiency” has the same meaning as the term “reportable condition” as used in AU §325 and AT §501 of the AICPA’s codification of GAAS. The terms “material weakness” and “significant deficiency” both represent deficiencies in the design or operation of internal control that could adversely affect a company’s ability to record, process, summarize and report financial data consistent with the assertions of management in the company’s financial statements. A “material weakness” constitutes a greater deficiency than a “significant deficiency.” Because of this relationship, it is the SEC’s judgment that an aggregation of significant deficiencies could constitute a material weakness in a company’s internal control over financial reporting.

permitted to conclude that the company's internal control over financial reporting is effective, if there are one or more material weaknesses in the company's internal control over financial reporting); and

- A statement that the registered public accounting firm that audited the financial statements included in the annual report containing the management's report has issued an attestation report on management's assessment of the registrant's internal control over financial reporting.

Under Instruction 1 to the applicable item, the Company must maintain evidential matter, including documentation, to provide reasonable support for management's assessment of the effectiveness of the Company's internal control over financial reporting.¹¹

The Company's annual report also must include registered public accounting firm's attestation report on management's assessment of the Company's internal control over financial reporting.

The term "internal control over financial reporting" is defined by the SEC as a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP and includes those policies and procedures that:

- Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the company;
- Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP, and that receipts and expenditures of the issuer are being made only in accordance with authorizations of management and directors of the company; and

- Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

The differences between "internal controls over financial reporting" and "disclosure controls and procedures." "Disclosure controls and procedures" are controls and other procedures that are designed to ensure that information required to be disclosed by the company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. These controls were discussed in our September 2002 client alert.

Item 307 of Regulations S-B and S-K and the corresponding Items of Forms 20-F and 40-F require a report by the CEO and CFO on the effectiveness of these disclosure controls and procedures. According to the SEC, some companies have indicated that disclosure controls and procedures are designed only to provide "reasonable assurance" that the controls and procedures will meet their objectives. In reviewing those disclosures, the SEC staff generally has not objected to that type of disclosure. The SEC staff has, however, requested companies including that type of disclosure to disclose, if true, the conclusions of the CEO and CFO that the disclosure controls and procedures are, in fact, effective at the "reasonable assurance" level.

However, according to the SEC, other companies have included disclosure that there is "no assurance" that the disclosure controls and procedures will operate effectively under all circumstances. In these instances, its staff has requested companies to clarify that the disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives and to disclose, if true, the conclusions of

¹⁰ Management must state whether or not the company's internal control over financial reporting is effective. The SEC's rules do not include standards for determining "effectiveness" of internal controls and procedures for financial reporting. However, a negative assurance indicating that nothing has come to management's attention to suggest that the company's internal control over financial reporting is not effective will not be acceptable to the SEC. The SEC is aware that some of the evaluation frameworks used to assess a foreign company's internal controls in its home country do not require a statement regarding whether the company's system of internal control has been effective. However, under the SEC's rules, management of a foreign company who rely on such an evaluation framework is nevertheless under an obligation to state affirmatively whether its company's internal controls are, or are not, effective.

¹¹ Section 13(b)(2)(A) of the Exchange Act requires companies to "make and keep books, records, and accounts, which in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer." See *In re Microsoft Corp.*, Administrative Proceeding File No. 3-10789 (June 3, 2002). In *Microsoft*, the SEC stated that such books and records include not only general ledgers and accounting entries, but also memoranda and internal corporate reports. It had previously stated that, as a matter of policy, under Section 13(b)(2) "every public company needs to establish and maintain records of sufficient accuracy to meet adequately four interrelated objectives: appropriate reflection of corporate transactions and the disposition of assets; effective administration of other facets of the issuer's internal control system; preparation of its financial statements in accordance with generally accepted accounting principles; and proper auditing." See Statement of Policy Regarding the Foreign Corrupt Practices Act of 1977, Release No. 34-17500 (Jan. 29, 1981).

the CEO and CFO that the controls and procedures are, in fact, effective at the “reasonable assurance” level.

The concept of reasonable assurance also is built into the definition of internal control over financial reporting that the SEC has adopted. This conforms to the standard contained in the internal accounting control provisions of Section 13(b)(2) of the Exchange Act and current auditing literature. The SEC has stated that, if management decides to include a discussion of reasonable assurance in the internal control report, the discussion must be presented in a manner that neither makes the disclosure in the report confusing nor renders management's assessment concerning the effectiveness of the company's internal control over financial reporting unclear.

The SEC has stated that, while there is substantial overlap between a company's disclosure controls and procedures and its internal control over financial reporting, there are both some elements of disclosure controls and procedures that are not subsumed by internal control over financial reporting and some elements of internal control that are not subsumed by the definition of disclosure controls and procedures. The broad COSO¹² description of internal control, which includes the efficiency and effectiveness of a company's operations and the company's compliance with laws and regulations (not restricted to be federal securities laws), would not be wholly subsumed within the definition of disclosure controls and procedures.

The SEC has indicated that a number of commenters have suggested that the narrower concept of internal control, involving internal control over financial reporting, is a subset of a company's disclosure controls and procedures, given that the maintenance of reliable financial reporting is a prerequisite to a company's ability to provide complete disclosure in its Exchange Act reports on a timely basis, because of the elements of internal control over financial reporting requiring a company to have a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. The SEC agrees that some components of internal control over financial reporting are included in disclosure controls and procedures for all companies. In particular, disclosure controls and procedures include those components of internal control over financial reporting that provide reasonable assurances that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles.

However, the SEC has pointed out that in designing their disclosure controls and procedures, companies can be expected to make judgments regarding the processes on which they

will rely to meet the applicable requirements. Some companies might design their disclosure controls and procedures so that certain components of internal control over financial reporting pertaining to the accurate recording of transactions and disposition of assets or to the safeguarding of assets are not included. The SEC gave as an example a company that might have developed internal control over financial reporting that includes as a component of safeguarding of assets dual signature requirements or limitations on signature authority on checks. That company could, nevertheless, determine that this component is not part of disclosure controls and procedures.

The SEC believes, therefore, that, while there is substantial overlap between internal control over financial reporting and disclosure controls and procedures, many companies will design their disclosure controls and procedures so that they do not include all components of internal control over financial reporting. For example, where a component of internal control over financial reporting is subsumed within disclosure controls and procedures, even where systems for testing of that component would clearly be required as part of the annual evaluation of internal control over financial reporting, management could make a different determination of the appropriate nature of the evaluation of that component for purposes of a quarterly evaluation of disclosure controls and procedures.

Location of management's report. The final rules do not specify where management's internal control report must appear in the company's annual report. The SEC, however, believes that it is important for management's report to be in close proximity to the corresponding attestation report issued by the company's registered public accounting firm. It expects that many companies will choose to place the internal control report and attestation report near the companies' MD&A disclosure or in a portion of the document immediately preceding the companies' financial statements.

Evaluation. The rules require management's report to identify the evaluation framework used by management to assess the effectiveness of the company's internal control over financial reporting. Management must base its evaluation of the effectiveness of the company's internal control over financial reporting on a suitable, recognized control framework that is established by a body or group that has followed due-process procedures, including the broad distribution of the framework for public comment.

A suitable framework must:

- Be free from bias;
- Permit reasonably consistent qualitative and quantitative measurements of a company's internal control;

¹² See footnote 13.

- Be sufficiently complete so that those relevant factors that would alter a conclusion about the effectiveness of a company's internal controls are not omitted; and
- Be relevant to an evaluation of internal control over financial reporting.

The COSO framework¹³ satisfies the SEC's criteria and may be used as an evaluation framework for purposes of management's annual internal control evaluation and disclosure requirements. However, the final rules do not mandate use of a particular framework, in part due to the SEC's, recognition that other evaluation standards exist outside of the United States, and that frameworks other than COSO may be developed within the United States in the future, that satisfy the intent of the statute without diminishing the benefits to investors.¹⁴ The SEC believes that use of standard measures that are publicly available will enhance the quality of the internal control report and will promote comparability of the internal control reports of different companies.

Auditor Attestation – Regulation S-X. The registered public accounting firm that reports on the audit of the company's financial statements, under Rules 1-02(a)(2) and 2-02(f) of the SEC's Regulation S-X, must attest to, and report on, man-

agement's assessment of the company's internal controls and procedures for financial reporting. The registered public accounting firm's report must be in accordance with the standards for such attestation engagements issued or "adopted"¹⁵ by the PCAOB.¹⁶

The registered public accounting firm's attestation report, either as a separate report or part of its audit report, is required to be filed with the company's annual report. The auditor's attestation report must be dated, signed manually, identify the period covered by the report and clearly state the opinion of the auditor as to whether management's assessment of the effectiveness of the company's internal control over financial reporting is fairly stated in all material respects, or must include an opinion to the effect that an overall opinion cannot be expressed. If an overall opinion cannot be expressed, the auditor must explain why, including the effects of any "material weaknesses."

Auditor independence issues. Because the auditor is required to attest to management's assessment of internal control over financial reporting, management and the company's independent auditors will need to coordinate their processes of documenting and testing the internal controls over financial reporting. The SEC has reminded companies and their audi-

13 See COSO, Internal Control-Integrated Framework (1992) ("COSO Report"). In 1994, COSO published an addendum to the Reporting to External Parties volume of the COSO Report. The addendum discusses the issue of, and provides a vehicle for, expanding the scope of a public management report on internal control to address additional controls pertaining to safeguarding of assets. In 1996, COSO issued a supplement to its original framework to address the application of internal control over financial derivative activities.

14 The SEC has stated that the assessment of a company's internal control over financial reporting must be based on procedures sufficient both to evaluate its design and to test its operating effectiveness. Controls subject to such assessment include, but are not limited to: controls over initiating, recording, processing and reconciling account balances, classes of transactions and disclosure and related assertions included in the financial statements; controls related to the initiation and processing of non-routine and non-systematic transactions; controls related to the selection and application of appropriate accounting policies; and controls related to the prevention, identification, and detection of fraud. The nature of a company's testing activities will largely depend on the circumstances of the company and the significance of the control. However, inquiry alone generally will not provide an adequate basis for management's assessment. The SEC further indicated that an assessment of the effectiveness of internal control over financial reporting must be supported by evidential matter, including documentation, regarding both the design of internal controls and the testing processes. This evidential matter should provide reasonable support: for the evaluation of whether the control is designed to prevent or detect material misstatements or omissions; for the conclusion that the tests were appropriately planned and performed; and that the results of the tests were appropriately considered. According to the SEC, the auditor that is required to attest to, and report on, management's assessment of the effectiveness of the company's internal control over financial reporting also will require that the company develop and maintain such evidential matter to support management's assessment. The SEC also recognizes that some controls operate continuously while others operate only at certain times, such as the end of the fiscal year. It believes that each company should be afforded the flexibility to design its system of internal control over financial reporting to fit its particular circumstances. The management of each company should perform evaluations of the design and operation of the company's entire system of internal control over financial reporting over a period of time that is adequate for it to determine whether, as of the end of the company's fiscal year, the design and operation of the company's internal control over financial reporting are effective.

15 Rule 1-02(a) of Regulation S-X defines "attestation report on management's assessment of internal control over financial reporting." See also, Sec. 103 of Sarbanes-Oxley. The PCAOB, with SEC approval on April 25, 2003, adopted the existing standards of the American Institute of Certified Public Accountant's Auditing Standards Board ("ASB"), as in existence on April 16, 2003. See Interim Professional Attestation Standards Rule 33005 (PCAOB Rel. No. 2003-006 (April 18, 2003)). The ASB's existing standards for attest engagements, thus, will apply until the PCAOB adopts its own standards. See AICPA Statement of Standards for Attest Engagements No. 10, which provides standards for attestation with respect to internal controls. Although the ASB is considering audit and attest standards for internal controls for financial reporting, it is not known whether the PCAOB will adopt these standards.

16 See Rule 2-02(f) of Regulation S-X for guidance as to the content of the auditor's attestation report. Section 103 of Sarbanes-Oxley requires the PCAOB to establish by rule standards to be used by registered public accounting firms in the preparation and issuance of audit reports. In carrying out this responsibility, the PCAOB must include in the auditing standards that it adopts, among other things: a requirement that each registered public accounting firm describe in each audit report the scope of its testing of the company's internal control structure and procedures performed in fulfilling its internal control evaluation and reporting required by Section 404(b) of Sarbanes-Oxley; present in the audit report (or attestation report) its findings from such testing; and an evaluation of whether the company's internal control structure and procedures: (1) include maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the company's assets; and (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with the authorization of management and directors of the company. In the audit report (or attestation report), the registered public accounting firm also must describe, at a minimum, material weaknesses in such internal controls and any material noncompliance found on the basis of such testing.

tors that its rules on auditor independence prohibit an auditor from providing certain nonaudit services to an audit client. Although the SEC stated in its auditor independence release that auditors may assist management in documenting internal controls, when an auditor is engaged to assist management in documenting internal controls, management must be actively involved in the process. While the SEC understands the need for coordination between management and the auditor, it has reminded companies and auditors that management cannot delegate its responsibility to assess its internal controls over financial reporting to the auditor. Management's acceptance of responsibility for the documentation and testing performed by the auditor will not satisfy the auditor independence rules.

Quarterly evaluation of internal controls and procedures for financial reporting. To provide a basis for the required quarterly disclosure about changes in the company's internal controls and procedures for financial reporting required by the SEC's rules under Sec. 302 of Sarbanes-Oxley, the company's management, under SEC Rules 13a-15 or 13d-15, now must evaluate the effectiveness of the design and operation of those controls and procedures with respect to both quarterly and annual reports as of the end of the period of the latest financial statements covered by the quarterly or annual report, rather than during the 90-period before the filing date of the report, as previously required. As discussed immediately below, the forms for CEO and CFO certifications have been revised to conform to these quarterly and annual assessment requirements.

The SEC's rules under Sec. 404 of Sarbanes-Oxley address evaluations of internal controls over financial reporting. The quarterly evaluations of these controls need not be as extensive as the annual review of these controls. Item 308(c) of Regulation S-K and the other applicable items require management, in the company's quarterly reports to disclose any change in the company's internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of Rule 13a-15 or 15d-15 that occurred during the company's last fiscal quarter (the company's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting. Foreign companies are not required to file quarterly reports, but are required to report such changes in their annual reports.

Communications with audit committees. The CEO and CFO are required to communicate to the company's audit committee (and its auditors):

- All significant deficiencies and material weaknesses in the design and operation of the company's internal control over financial reporting that are reasonably likely to

adversely affect the company's ability to record, process, summarize and report financial information; and

- Any fraud, whether or not material, that involves either management or employees who have significant roles in the company's internal control over financial reporting.

Amendments to CEO and CFO Certification Requirements.

The requirements for annual and quarterly CEO and CFO certifications under Sec. 302 of Sarbanes-Oxley and SEC Rules 13a-14, 13a-15 and 15d-14 and 15d-15 have been amended to require CEOs and CFOs to certify, in addition to their certifications relating to disclosure controls and procedures, to certain matters relating to internal control over financial reporting and the assessment of that control. Specifically, CEOs and CFOs will be required to certify in the exact language specified in the rule that:

- They have reviewed the specified report of the company;
- Based on their knowledge, the report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- Based on their knowledge, the financial statements, and other financial information included in the report, fairly present in all material respects the financial condition, results of operations and cash flows of the company as of, and for, the periods presented in this report;
- They are responsible for establishing and maintaining disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f))¹⁷ for the company and have:
 - Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under their supervision, to ensure that material information relating to the company, including its consolidated subsidiaries, is made known to them by others within those entities, particularly during the period in which this report is being prepared (The SEC has stated that the CEO and CFO may have the required controls and procedures designed under their supervision. They personally do not need to design them.);
 - Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability

¹⁷ The latter certification is deferred until the first annual report containing the required management report on internal control over financial reporting.

ty of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;¹⁸

- Evaluated the effectiveness of the company's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by the report based on such evaluation; and

Note that the "Evaluation Date" now is the end of the period covered by the annual or quarterly report.

- Disclosed in the report any change in the company's internal control over financial reporting that occurred during the company's most recent fiscal quarter (the company's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting; and
- They have disclosed, based on their most recent evaluation of internal control over financial reporting, to the company's auditors and the audit committee of the company's board of directors (or persons performing the equivalent functions):
 - All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the company's ability to record, process, summarize and report financial information; and
 - Any fraud, whether or not material, that involves management or other employees who have a significant role in the company's internal control over financial reporting.

The SEC has the extended compliance period to the portion of the introductory language in paragraph 4 of the Sec. 302 certification that refers to the certifying officers' responsibility for establishing and maintaining internal control over financial reporting for the company and paragraph 4(b), which must be provided in the first annual report required to contain management's internal control report and thereafter. This extended compliance period does not in any way affect the provisions of our other rules and regulations regarding internal controls that are in effect.

Exhibit requirement. The CEO and CFO certifications required by Sec. 302 and Sec. 906 of Sarbanes-Oxley must be provided as exhibits to the relevant reports commencing on August 14, 2003. (Until the SEC modifies its EDGAR system to accept these exhibits and announces the modification, they should be provided as Exhibit No. 99.)

- **Sarbanes-Oxley Sec. 302 Certifications.** These certifications must be filed as exhibits to quarterly and annual reports filed with the SEC, including amendments to those report, even if the amendments do not contain financial statements. These certifications are not required with respect to reports on Forms 6-K, 8-K or 11-K.
- **Sarbanes-Oxley Sec. 906 Certifications.** CEO and CFO certifications must be "furnished" as exhibits to annual and quarterly reports filed with the SEC that include financial statements. These certifications are not required in amendments to these reports, if the amendments do not contain financial statements. (Pending further interpretation by the Department of Justice, it would be prudent to furnish these certifications as exhibits to reports on Forms 6-K, 8-K or 11-K, if those reports contain financial statements.) A certification "furnished pursuant" to Sec. 906 and the SEC's exhibit requirement will not be deemed "filed" for purposes of section 18 of the Exchange Act, or otherwise subject to the liability of that section. Also, the certification will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the issuer specifically incorporates it by reference.¹⁹

Foreign Companies

The management report and CEO and CFO certification requirements apply to both domestic and foreign reporting companies. However, foreign private issuers have been provided the transition relief mentioned. Moreover, they are not required to file quarterly reports and, thus, their management will not be required to conduct quarterly evaluations or updating of those companies internal controls over financial reporting. They will, however, be required to disclose, in their annual reports changes in internal control over financial reporting during the year covered by the report that have materially affected or are reasonably likely to materially affect the company's internal control over financial reporting.

Small business issuers. These rules apply to "small business issuers," as defined in SEC rules, with the special transition period for "non-accelerated filers" mentioned above.

¹⁸ "GAAP." GAAP means U.S. GAAP for domestic issuers or the home country GAAP of a foreign private issuer, as the case may be. This certification is deferred until the first annual report containing management's report on such internal controls.

¹⁹ Sec. 906 certification furnished as exhibits to periodic reports before August 14, 2003, should insert the following legend after the text of each certification: "A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to [name of the company] and will be retained by [name of the company] and furnished to the Securities and Exchange Commission or its staff upon request."

Procedures. Public companies, in addition to designing, implementing and testing internal control over financial reporting, will have to develop policies and procedures for, among other things:

- Management reports on internal controls over financial reporting, including designating persons responsible for this reporting and review and evaluation of the controls, communications with independent auditors attesting to the controls and coordinating with CEO and CFOs certification procedures;
- Quarterly evaluations;
- Appropriate documentation;
- The CEO's and CFO's additional certification requirements; and
- Communications with audit committees and the auditors attesting to management's statements in its report.

Conclusion

These new rules, as the SEC recognizes, substantially add to the burden on public companies, especially foreign companies and smaller domestic companies, their audit committees and their independent auditors, CEOs and CFOs imposed by Sarbanes-Oxley and the SEC's rules under that Act. However, adoption and implementation of these requirements should assist in efforts to regain investor confidence in our financial reporting system.

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Client Alert

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