

JULY 11, 2002

PREPARING FOR OFFICER CERTIFICATION REQUIREMENTS

Introduction

The SEC's June 27, 2002 Order requiring the principal executive and financial officers of nearly 1,000 of the largest U.S. publicly traded companies to separately file with the SEC a statement in writing, under oath, regarding the accuracy of their company's most recently filed annual report on Form 10-K, and all quarterly reports on Form 10-Q, current reports on Form 8-K and definitive proxy materials filed thereafter triggers two obvious questions in the mind of every affected CEO and CFO: **"What steps should I take before I sign off?"** and **"What new liability may I or my company face?"**

The SEC's June 27 Order follows an earlier, June 17 SEC proposed rulemaking calling for CEOs and CFOs to certify future annual and quarterly reports. The SEC is soliciting comment on the June 17 proposal until August 19. The Order also follows earlier recommendations by the NYSE and President Bush that executives should vouch for their company's disclosures.

While "best practices" (or at least "market standards") will develop as to how affected companies and executives should approach the certification process, we thought it might be helpful given the limited time frame to offer selected suggestions that a company subject to the June 27 Order and its executives might wish to consider in preparation for the certification required by the Order. These suggestions may be equally applicable if the SEC's June 17 proposed rulemaking, which is discussed below, becomes effective and indeed some of these suggestions borrow from comments made by the SEC in its proposed rulemaking. In the course of the discussion, we also address certain special circumstances that may apply to selected situations.

We would like to stress that the information contained herein only presents possible approaches for consideration and does not represent an exclusive list of steps that could be taken. Moreover, none of the possible approaches necessarily represents a panacea in and of itself for the certification process. Each company and its certifying officers will need to assess their needs based on their particular facts and circumstances, including, among others, what steps were taken in connection with the preparation and review of the covered filings. That being said, we would be pleased to discuss any compliance program features that you and your company may be considering or provide any assistance that may be required in developing a compliance program. Regardless of whether any of the suggestions contained in this Client Bulletin are followed, companies subject to the Order should promptly formulate and document whatever procedures they currently have in place or implement so as to create a record of the steps taken if future reference to the procedures is necessary.

We also note that we are not commenting in this Client Bulletin on the SEC's authority to issue the June 27 Order, nor should anything contained herein be construed as addressing that matter.

The SEC's Recent Certification Order. As we noted in our Client Bulletin of June 28, on June 27 the SEC issued an Order requiring the principal executive and financial officers of nearly 1,000 of the largest U.S. publicly-traded companies to separately file with the SEC on a one-time basis a statement in writing, under oath, that "to the best of [his or her] knowledge" and except as subsequently corrected or supplemented, the most recent report on Form 10-K and subsequent reports on Form 10-Q, reports on Form 8-K, and definitive proxy materials of their respective companies "contained [no] untrue statement of a material fact" or "omitted to state a material fact necessary to make the statements [included in the filings] . . . not misleading" with respect to the period covered by the report (or date of filing, in the case of reports on Form 8-K or definitive proxy materials). While the Order provides that executives can file a sworn statement describing the facts and circumstances that would make the required certification incorrect, the practicality of providing such a sworn statement without correcting the relevant document is questionable. The Order also requires that the sworn statement include a declaration as to whether it has been reviewed with the issuer's audit committee or, in the absence of an audit committee, the independent directors.

The Order is not a proposed rule; it is effective immediately and the certification is mandatory. For companies with calendar year-end fiscal years and any other companies required to file a Form 10-Q for the period ended June 30, 2002, the statement must be filed in writing (electronic filing will not be permitted) by close of business on August 14, 2002. The SEC has stated that the certifications will be made public.

The SEC's Proposed Rulemaking. The SEC's June 27 Order, issued shortly after WorldCom announced a \$3.8 billion earnings restatement, followed the SEC's earlier announcement on June 17, 2002 of proposed rules that would require CEOs and CFOs of all publicly reporting U.S. companies (regardless of size) to certify, among other things, that to the officer's "knowledge," the information contained in the company's annual and quarterly reports is "true in all important respects" when they are filed. As noted in our Client Bulletin of June 24, the SEC's June 17 proposed rules would also require public companies to create and maintain procedures to ensure the collection, processing, and disclosure of all information required to be filed with the SEC and require the CEOs and CFOs to represent that they have reviewed the results of an annual evaluation of those procedures. Procedures recommended in the proposed rule include the establishment of a disclosure committee comprised of senior officers. The proposed rules are subject to the SEC's rulemaking process and the SEC is soliciting comment on the proposed rule until August 19, 2002. In contrast to the Order, the certification proposed by rule would cover only reports on Form 10-K and reports on Form 10-Q. Current reports on Form 8-K and proxy materials would not be covered. Although there are a number of other differences and distinctions between the SEC's June 27 Order and its June 17 proposed rules that are beyond the scope of this Client Bulletin (including the different "knowledge" standards that they contain), in the end they either require or suggest that companies have or formulate procedures for complying with the certification requirements.

The NYSE's Certification Proposal. The SEC's June 17 proposed rules calling for CEO and CFO certification of quarterly and annual reports in turn followed the NYSE's release on June 6, 2002 of a report from a blue-ribbon committee that proposed, among other things, changes in NYSE listing requirements to compel each listed company's CEO to certify annually to the NYSE that 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 NYSE's proposed changes to its listing standards were discussed in our Client Bulletin of June 20, 2002.

President Bush's Statements on Corporate Responsibility. As part of his speech on July 9 in New York City setting forth his Administration's views on corporate accountability, President Bush reiterated his view, earlier expressed in March when he announced his 10-point plan on corporate responsibility, that CEO's should "personally vouch" for their company's financial statements and he specifically endorsed the SEC's June 27 Order.

Preparing for the Certification Mandated by the June 27 Order and Possible On-Going Certifications

In preparing for the certification mandated by the June 27 Order, a company and its executives may wish to consider implementing the procedures called for by the SEC's June 17 proposed rules to the extent that those procedures are practicable given, among other things, the fact that the Order requires the executives to certify to reports that have previously been prepared and filed.

Systems and Culture. A starting point for supporting the officer's "best knowledge" as to accuracy and completeness of SEC filings should be consideration of the current disclosure procedures in light of the SEC's June 17 proposed rulemaking that would require the creation, maintenance and annual evaluation of procedures for addressing disclosure requirements. The best procedures in the world, however, will be inadequate unless there is also a clear message from the top that the company places a high priority on excellent disclosure practices – no matter what may be the short-term impact on trading prices. Especially for the companies identified in the June 27 Order, now would be an auspicious time for that message to be conveyed by the certifying officers (if not the board of directors) in a communication to appropriate members of the company staff and to the company's outside advisors. That message should include, but go beyond, "I'm counting on you." The deeper message should be that the company wants to take a leadership role in addressing the serious credibility problem currently facing Corporate America in light of recent events and set an example.

Creation of Disclosure Committee. As we have noted, the SEC's June 17 proposed rules recommend the formation of a disclosure committee to review and discuss each filing subject to the certification. Although not required, such a committee also could be used with regard to the certification called for by the SEC's June 27 Order. The composition of the committee may vary. If used, the committee should meet promptly and review the content of filings that would be subject to the certification. Clearly, the committee should be given enough time to do a thoughtful and thorough job. Parties should consider whether documentation of the committee's efforts would be appropriate, such as whether a brief written report of that committee should be submitted to each certifying officer before he or she signs off.

Sensitive Areas. It may also be important for the disclosure committee and the certifying executives, with the assistance of outside advisors as necessary, to review the extent to which (if any) the subject company has any accounting issues of the type that have come to light with respect to certain public companies that have received media attention of late and prompted concern. Such key areas might include, but certainly not be limited to, transactions with related parties, revenue recognition policies, accounting firm relationships, audit committee matters, expense and capitalization accounting policies, employee pension plan matters, off-balance sheet accounting matters and executive compensation arrangements. The SEC has also shown a great deal of interest in non-GAAP financial measurements and in what it calls “critical accounting estimates.”

Correcting or Supplementing Prior Disclosures. Companies and certifying executives subject to the June 27 Order may also want to consider whether it would be appropriate to use the up-coming Form 10-Q filing (for calendar year companies) to correct or supplement items contained in earlier filed reports that are of concern from a disclosure standpoint or whether it would be appropriate to amend previously filed reports or make separate Form 8-K filings prior to certification to correct disclosures made in a covered report, rather than have to make any such corrections or supplements as part of the certification process itself. We want to emphasize, however, that this is not to suggest that any such correction or supplement should be made without considering the full implications. Moreover, notwithstanding the current highly charged atmosphere, there has not been any change in the legal standard of review to be applied to publicly filed documents.

Possible Additional Procedures. Certifying officers may also wish to require certain additional procedures be undertaken before sign-off. For example, it may be appropriate to assign senior staff or counsel to review the public disclosures subject to the certification against materials supplied to the board of directors. (Note that the SEC enforcement division used board materials to impeach public disclosures in the *Caterpillar* proceeding.) In other instances, the certifying officers may ask certain individuals — *e.g.*, general counsel, controller, internal audit staff and key business unit heads — to provide a back-up “negative assurance” as to specific sections of the reports. Recent public pronouncements from SEC staff to the effect that “in accordance with GAAP” does not equate to “not misleading” suggest that accounting professionals should be asked to comment beyond technical compliance with accounting rules.

Personal Review. Finally, there is no substitute for a personal review of the SEC filings by the certifying officer. It is self-evident that a certifying officer will be at a disadvantage in trying to prove “best knowledge” without reading the filings to which the certification applies. Executives must assume that, if the company or executives in question were ever subject to litigation or administrative action over items in the SEC reports to which the certification applies or to the certification itself, they will be asked later to articulate — precisely — what diligence steps were taken before the certification was signed. Accurate, contemporaneous documentation describing these steps may prove helpful although there is always the risk that a critical step may be viewed as missing. Moreover, if there is any item in any filed report subject to certification that the executive does not understand, he or she should question management, the disclosure committee or outside advisors as to the meaning of the item.

Another possible component of a personal review might be learning from the vetting of financial statements by the audit committee. Whether this takes place by observing the meetings or an after-the-meeting report will depend upon how the audit committee chair feels about attendance by the certifying officers during non-executive sessions.

While the foregoing possible procedures may apply equally to the certification called for in the June 27 Order and the certifications called for in the SEC's June 17 proposed rulemaking, a few items bear special mention with regard to the certification required by the Order. First, except as corrected or supplemented in a subsequent report, the accuracy and completeness of each previously filed report is to be certified to as of the end of the period covered by the report (or date of filing, in the case of reports on Form 8-K or definitive proxy materials). This may require a review of the files (and contemporaneous board materials) as of that date. Second, the certification requires an indication as to whether it has been reviewed with the audit committee or, in the absence of the audit committee, the independent directors. While the Order does not mandate that the audit committee review the CEO and CFO certifications, it would appear that most companies will wish to certify in the affirmative or suffer the implications of such a negative reference. Companies should – as soon as possible – consider scheduling an audit committee meeting (or meeting of independent directors) to be held before the certification is required to be filed.

Special Circumstances

Pending SEC Comment Letters. Certain issuers may be in the process of responding to SEC comment letters on 1933 or 1934 Act filings. When those letters include accounting comments relating to historical disclosure (and especially if possible restatements of financial statements are involved), or otherwise request amendments to prior filings, some thought should be given to whether to address that fact in the certification process by means of an 8-K filing or by referring to SEC comments as part of the “facts and circumstances” that might make the normal certification inappropriate. If the executive's sworn statement includes a reference to such a comment letter, the company will need to consider the need for additional public disclosure of the existence of the comment letter.

New Officers. The certification requirements of the June 27 Order would pose a daunting task for an officer who is new to his or her current position – especially coming from outside the company. Any such individual may wish to note his or her starting date in the transmittal letter used to submit the notification. However, any officer doing so should consider the possibility that such a statement could raise the question as to whether his or her certification is adequate and could be noted in any published report of exceptions. Under these circumstances it will be especially important for the new officer to be able to demonstrate that the officer's review of the covered documents in support of the certification was thorough and that the officer clearly understood that there is no “new officer” carve-out for compliance with the Order.

New Auditors. Certain issuers may have recently changed the principal accounting firm engaged to audit their financial statements. As part of accepting the new engagement, the recently engaged accounting firm will likely have conducted its own informal review of the financial statements included in the reports subject to the certification requirements of the June 27 Order. Under these

circumstances, the certifying officers of the issuer should discuss with representatives of the new accounting firm any issues that they identified in conducting their review that might impact the certification.

Undisclosed Negotiations Regarding Corporate Transactions. The SEC's June 17 proposed rules would require a certifying officer to certify, in part, that, to his or her knowledge, the report in question "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." The definition of what will be considered "important to a reasonable investor" under the proposed rules closely paraphrases the familiar definition of "materiality" contained in *TSC Industries, Inc. v. Northway, Inc.* and *Basic, Inc. v. Levinson*. Accordingly, the proposed rules create the possibility that a certifying officer with no other duty to disclose pending negotiations concerning a significant corporate transaction might be required to disclose the negotiations in order to be able to give the requisite certification. No doubt this possibility that the proposed rules create a new duty to disclose will be actively discussed as the SEC and NYSE proposals are considered. For now, we note that, when giving the certification required by the June 27 Order, the traditional rules concerning the duty to disclose still apply.

Regulation FD Disclosure in Form 8-K Reports. Certifying officers of issuers that have filed reports on Form 8-K containing forward-looking "guidance" in order to comply with the requirements of Regulation FD should be mindful of the fact that, with the possible exception of information filed under Item 9 of Form 8-K, those 8-K reports will be included among the documents covered by the certification requirements of the June 27 Order. It is uncertain whether information furnished under Item 9 of Form 8-K is subject to the Order. Particular attention should be given to any cautionary language accompanying forward looking statements made in covered 8-K reports.

Filing Certification In Advance of Deadline. We have been advised by the SEC staff that if a certification required by the June 27 Order is filed before the applicable deadline no additional sworn statements will be required to cover reports and proxy materials that are filed thereafter but before the deadline. This means, for example, that if the CEO and CFO of a company with a report on Form 10-Q required to be filed not later than August 14 file their certifications prior to the filing of that Form 10-Q, no additional certification under the June 27 Order will need to be made in respect of that Form 10-Q. CEOs and CFOs contemplating filing early certifications in this manner should consider carefully the inferences that might be drawn in taking that approach.

Filing Extensions. Although not addressed in the June 27 Order, SEC staff has confirmed that if a company properly files a Form 12b-25 to extend the due date for its first Form 10-K or Form 10-Q due on or after August 14, 2002, it would have the effect of providing a similar extension of the deadline for compliance with the Order.

Liability Aspects

The June 27 Order has been issued pursuant to Section 21(a) of the 1934 Act. That section authorizes the SEC to engage in investigations to determine whether any person has violated, or is violating, the federal securities laws. In issuing the Order, the SEC indicated that it has commenced an investigation into the accounting practices of nearly 1,000 of the largest U.S. publicly traded companies. Since this may be the first time in recent history that the SEC has issued an order of this nature, the parameters of the potential liability of those who must file certifications beyond that which may already exist for chief executive and financial officers is not entirely clear. Nevertheless, the SEC unambiguously declared in a press release describing the Order that “[o]fficers who make false certifications will face personal liability.” In public appearances following the SEC’s issuance of this Order, SEC Chairman Harvey Pitt has stated that “if the information [in the certifications] is false, they will go to jail.”

But beyond the public statements surrounding the issuance of the June 27 Order, the Order raises significant issues of potential civil, criminal and SEC enforcement liability, both for individuals who provide the certifications and their public company employers. If an executive does not comply with providing the certification, or it is subsequently determined that a false or misleading statement has been provided, the party providing the statement could be subject to civil suit by the SEC and face SEC administrative proceedings. The remedies sought by the SEC could include, among others, seeking to bar individuals from serving as an officer or director of public companies. Filing of a false certification may also give rise to private securities fraud lawsuits against the certifying officers by shareholders for violation of the antifraud provisions contained in SEC Rule 10b-5. Although the SEC suggested in the June 17 proposed rulemaking that the proposed certification requirement would not expose executives to any additional liability because, in its view, they already have essentially the same responsibilities for the disclosures that they would be required to certify, it would appear that some incremental potential liability would attach as a result of the certification process. Moreover, as a result of submitting the certifications and the SEC making those certifications public, as is expected (and as the SEC did with respect to the WorldCom matter), it may be somewhat more difficult for executives to avoid liability by claiming they were unaware of facts giving rise to potential claims.

Finally, knowingly making a materially false statement to the federal government can be a felony. The SEC is likely to make referrals for criminal prosecution to the Department of Justice when it believes that a CEO or CFO knowingly made a false statement on their officer certification. Moreover, false statement cases are among federal prosecutors’ favorite claims to prosecute because they can be proven more easily than a complicated fraudulent scheme. We would not be surprised to see the SEC and Justice Department seek out an early test case involving a false certification.

Final Observations

The certification requirements will, no doubt, add time and expense to the disclosure process. Indeed, on the subject of expense, some companies may want to consider adding staff to assist in developing the kind of record of diligence from which certifying officers will derive some protection.

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For more information on preparing for the certification called for in the SEC's June 27 Order, preparing any comments on the SEC's June 17 proposed rules or planning for their possible implementation, or to share any comments you may have on aspects of the foregoing, please call your regular Sidley Austin Brown & Wood contact or any of the attorneys listed below.

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