



**FENWICK & WEST LLP**

*CORPORATE & SECURITIES LAW UPDATE*

## **SEC Proposes New Rules: Officer Certification of Forms 10-Q and 10-K**

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## SEC Proposes New Rules: Officer Certification of Forms 10-Q and 10-K

On June 17, 2002, the SEC proposed additional changes in the public company disclosure regime. The major elements of the proposed changes are:

- To require the chief executive officer and chief financial officer of a company to certify the contents of the company's Forms 10-Q and 10-K; and
- To require the company to maintain procedures to assure its ability to collect, process and disclose the information required in Forms 10-Q, 10-K and 8-K, and to evaluate those procedures at least annually.

These proposals are in addition to various other recent SEC proposals designed to enhance the public company disclosure system. To view the full text of the proposed rules, which were posted by the SEC on June 17, 2002, click here:

<http://www.sec.gov/rules/proposed/34-46079.htm>.

A summary follows.

### Certification of Quarterly and Annual Reports

#### Who must certify the reports on Forms 10-Q and 10-K?

The SEC proposes that every reporting company's principal executive officer and principal financial officer must sign the certification, which will appear on the signature page of the report, regardless of, and in addition to, whoever is signing the Forms 10-Q and 10-K on behalf of the company.

Foreign private issuers would not be subject to the proposed certification requirements.

#### What would the officers certify?

The SEC proposes that, in each Form 10-Q and Form 10-K, the chief executive officer and chief financial officer certify that:

- he or she read the report;
- 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; and
- the report contains all information about the company of which he or she is aware

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that he or she believes is important to a reasonable investor as of the last day of the period covered by the report.

In addition, the SEC proposes that the officers also certify, on Forms 10-K only, that:

- he or she has reviewed the results of an evaluation of procedures maintained by the company to collect, process and disclose on a timely basis the information required to be disclosed in the company's periodic and current reports.

**What does "important to a reasonable investor" mean?**

The proposed officer certification would state that information is considered "important to a reasonable investor" if:

- 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 were omitted from the report.

**What must a company do in order for the officers to provide the certification?**

Each public company would be required:

- to maintain procedures sufficient to provide reasonable assurance that the company is able to collect, process and disclose the information required in the company's Forms 10-Q, 10-K and 8-K;
- within the twelve months before the Form 10-K filing, to evaluate the effectiveness of the design and operation of the reporting procedures, and at a minimum to identify:
  - any material weaknesses in the procedures;
  - any other deficiency that would significantly impair 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; and
- before filing the Form 10-K, the company's principal executive officer, principal financial officer and board of directors must review the results of the evaluation.

**Is the SEC recommending any specific internal systems or evaluation processes?**

The SEC is recommending (but not requiring) that each company create a committee responsible for materiality determinations and timely disclosure. That committee would:

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- report to senior management, including the chief executive officer and chief financial officer; and
  - include employees and officers such as the controller, general counsel, principal risk management officer, chief investor relations officer and other appropriate individuals.

If a company failed to maintain adequate procedures and review them properly, the SEC states that it could take action against the company even where the failure did not lead to flawed disclosure.

**Is a new definition of "materiality" being proposed?**

No. The SEC states that it intends the phrase "important to a reasonable investor," which appears in the certification, to equate to the current standards for "material" information that is set out in cases, including *TSC Industries v. Northway, Inc.* and *Basic, Inc. v. Levinson*. Also, the certification follows the general materiality standard contained in Exchange Act Rule 12b-20.

**What are the liability risks to the corporate officers who certify the Forms 10-Q and 10-K?**

The SEC believes the certification requirements would "reinforce" the responsibility corporate officers who sign SEC reports already have to security holders for the contents of Forms 10-Q and 10-K. An officer who provides a false certification could be subject to SEC action for violating Section 13(a) of the Exchange Act and to both SEC and private actions for violating Section 10(b) and Rule 10b-5 under the Exchange Act. Each person who signs the Form 10-K or Form 10-Q already has these liabilities. Currently many Forms 10-Q are signed by one officer only, and not by the chief executive, so the net effect of the proposal would be that more officers would have potential liability for material misstatements and omissions in periodic filings.

**What level of inquiry does the disclosure certification require?**

The proposed certification is limited to the knowledge of the chief executive officer and chief financial officer, and to their belief as to whether the information would be important to a reasonable investor. The SEC states that the officers would not have to inquire separately as to information not known to them. However, the SEC states that while the officers would not have to undertake a separate inquiry as to information not known to them, their critical review of an SEC report would necessarily include other inquiries where appropriate, including inquiring into disclosures they do not understand or into the materiality of information.

**Does the Form 10-K disclosure certification also cover disclosures in a proxy statement incorporated by reference into the Form 10-K?**

Yes. As a result, the internal procedures instituted to bring material information to the attention of management should take this into account in determining what information must be gathered.

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**How are amendments to a Form 10-Q or Form 10-K affected by the rule proposals?**

Currently, an amendment to a Form 10-Q or 10-K requires only a signature of a duly authorized officer. The proposed rules do not alter this procedure and do not require any certifications to appear on the amendment signature page.

**When will these new rules take effect?**

The proposed rules described above are open for public comment until August 19. It is expected that the SEC will issue final rules on this topic shortly thereafter.

**Next Steps**

While this proposal may be controversial, the substance of it has been identified as a presidential priority, and the leadership of the SEC has stated its intention to take action in this area. The rules that are finally adopted may be significantly modified from what is proposed. We would be happy to provide you with additional information on the proposals and will provide further information on the final rules when they are announced.

If you have any questions about this, please contact anyone on your Fenwick & West team, or [fwcsu@fenwick.com](mailto:fwcsu@fenwick.com).