

CORPORATE COMPLIANCE UPDATE:

CEO/CFO CERTIFICATION OF SEC PERIODIC REPORTS EFFECTIVE IMMEDIATELY FOR ALL ISSUERS

Additional Developments in Separate SEC Order Certification

Yesterday, President Bush signed into law the Sarbanes-Oxley Act of 2002 (the "Act"), summarized in our previous memorandum of July 29, 2002. As we noted in the memorandum, the Act mandates two overlapping but separate CEO/CFO certifications. Although the legislation and legislative history are somewhat ambiguous, it appears that the requirement for the second certification is effective immediately. In the absence of clear guidance from the SEC, we recommend that companies prepare to make the required certification in their next 10-Q or other periodic report.

CEO/CFO Certifications

Three CEO/CFO certifications have been recently mandated:

- The SEC in late June issued an order requiring the CEOs and CFOs of nearly 1,000 large public companies, on the due date of their next periodic report due on or after August 14, 2002, to personally certify, to the best of their knowledge, that their company's most recent SEC filings did not either (1) contain an untrue statement of a material fact or (2) omit a material fact necessary to make the statements in the report not misleading. Please see our memo of July 15, 2002 for more information about this SEC order. **See also below for further developments regarding this certification.**
- Section 302 of the Act requires the CEOs and CFOs of public companies to make a certification similar to the one mandated by the SEC order in each of their companies' SEC quarterly and annual reports. In addition, the officers must certify, based on their knowledge, that the financial information in the report presents in all material respects the financial condition and results of operations of the company. It further requires the officers to make certain certifications as to their company's internal controls. **The Act provides that this requirement will not take effect until the SEC adopts rules regarding this certification within the next 30 days.**
- Section 906 of the Act provides for yet another CEO/CFO certification. It requires each periodic report filed with the SEC that contains financial statements to "be accompanied" by a written statement from the CEO and CFO certifying that:

- (1) the periodic report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) the information contained in the periodic report fairly presents, in all material respects, the financial condition and results of operations of the issuer.

As this Section does not contain any delaying provision, **this certification requirement appears to be effective immediately.** It remains to be seen whether the SEC will reconcile the overlapping text of the Section 302 and 906 certifications.

- Although there are technical arguments why this requirement may not take immediate effect and there is some legislative history supporting this view, in the absence of clear guidance from the SEC, we recommend that issuers include such a certification with their next 10-Q or other periodic report.
- These certification requirements apply to all public companies, even companies that qualify as foreign private issuers.

Section 906 Certification Issues

This Section 906 certification requirement raises the following additional issues:

- No procedure for filing the certification is described in the Act. Possible methods include delivering it separately to the SEC (like the certification pursuant to the SEC order) or including it in the filing of the periodic report, either on or following the signature page or as a separate exhibit.
- Unlike the SEC order certification, no precise form of the certification has been provided. However, given the SEC's statements in connection with the order (as described below), we advise against deviating from the text provided in the Act.
- Unlike the two other certifications, this Section 906 certification does not contain an express "knowledge" qualification. However, the criminal penalties under the Section apply only when the CEO or CFO certifies the statement "knowing" that it does not comply with the requirements. This knowledge standard was intentionally included in the final version of the bill, instead of the lower "reckless" standard proposed in a previous version.
- Under Section 906, certifying a statement "knowing" that it does not comply with the requirements subjects the CEO or CFO to a fine of up to \$1,000,000 and/or ten years of imprisonment. "Willfully" doing so subjects the CEO or CFO to a fine of up to \$5,000,000 and/or twenty years of imprisonment. A person acts "knowingly" if he or she acts intentionally and voluntarily and not because of ignorance, mistake, accident or carelessness. Reckless disregard of obvious red flags is probably sufficient to

satisfy this standard. Acting “willfully” requires a finding that the person acted with knowledge that his or her conduct is unlawful and with the intention to disregard the law. We will continue to monitor the SEC and Department of Justice for further developments clarifying these standards.

- Although Section 906 only provides for criminal penalties for making false certifications and does not suggest any penalties for failing to file the required certifications, the Section begins by stating that all periodic reports containing financial statements be accompanied by the requisite certification. Failure to include these certifications may subject the company to an enforcement action by the SEC, which is given full authority to enforce the provisions of the Act.
- The certification that the report “fully complies” with the Exchange Act does not contain a materiality qualification, though we note that many of the applicable Exchange Act requirements themselves contain a materiality standard.
- Although “periodic reports” is not defined in the Act, we do not believe they extend to Current Reports on Form 8-K that contain financial statements. However, it probably does include Form 6-Ks filed by foreign issuers that include quarterly financial information. This also remains subject to clarification by the SEC.

Preparation for Delivering Certifications

As discussed in our July 15, 2002 memorandum on the SEC order certification, in preparation for delivering the certification, the CEO and CFO should:

- convene meetings with other members of management to discuss in detail the financial and operational disclosures in the report;
- meet with the company’s auditors to obtain their views of the company’s disclosures, financial statements and accounting policies;
- emphasize to all parties that participate in this inquiry that they want candid answers to their questions regarding disclosures and reporting policies and procedures.

In addition, in anticipation of the effectiveness of the Section 302 certification, the officers should begin to review their internal audit controls and procedures so that they are in a position to make the requisite certification. Although this certification is not likely to be due until the filing of the 10-Q for the third quarter, officers will need adequate time to identify and correct any weaknesses.

Additional Immediate Concerns

The enactment of the Act also makes the following provisions effective immediately or in the next 30 days:

- New loans to directors and executive officers are *now* prohibited. Existing loans are “grandfathered,” but may not be renewed or modified. Until the scope of these provisions is clarified, companies should refrain from making new credit arrangements (including guarantees) or renewing credit arrangements.
- Effective August 29, 2002, insider stock transactions will be required to be reported to the SEC before the end of *the second business day* following the execution of the transaction. The Act gives the SEC the flexibility to provide for the filings to be made later if it determines that the two day filing period “is not feasible,” but it is unclear whether the SEC will take advantage of this provision.
- The new criminal penalties for securities fraud and altering documents that are subject to federal investigations are effective immediately.
- Other important provisions of the Act, including disgorgement of CEO and CFO compensation following restatements and Federal protection for whistleblowers, also take immediate effect. Many of the other provisions, including the accounting oversight board, auditor independence requirements, audit committee standards, enhanced disclosure requirements, rules of professional responsibility for attorneys and retention of audit records, remain subject to SEC and other rulemaking.

Additional Developments Regarding SEC Order Certification

- The list of companies on the SEC website that are required to file this certification has been expanded into a chart, which will include a link to each company’s certification and will indicate whether or not the certification is fully compliant. We understand from the SEC that they expect to add another column indicating when the certification is due, to cover companies that do not have a calendar fiscal year.
- The SEC has taken a hard line against even minor changes in the text of the certification (even inconsequential changes such as adding “as defined below”) and has urged officers to “refrain from making *any* changes to the form.” Failure to follow the exact text, or even adding qualifications in an accompanying cover letter, risks having the filing classified in the noncompliant “all other” category.
- The SEC has also stated that these certifications are “nearly certain to be material information regarding the Companies” and suggests that, until publicly disclosed, they should be treated as any other material non-public information. The SEC recommends that companies, in addition to filing the certifications under the order, (1) file an Item 9 or Item 5 Form 8-K when the statements are completed and signed,

disclosing the filing of the statements and attaching the statements as exhibits to the Form 8-K, (2) post the statements on their websites and (3) take any other appropriate steps to ensure broad dissemination of the certifications.

- The certification must be delivered in written form on paper, including via facsimile (but *not* email), to the Secretary of the SEC by the close of business on the due date. A facsimile should be followed by an original. The fax numbers for the Secretary's office for certifications filed on August 13, 14 and 15 are (202) 824-5090 or 5091. Certifications filed on any other day should be faxed to (202) 942-9651.

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If you wish to obtain additional information regarding this new legislation or other initiatives, assistance in developing a detailed program to help ensure compliance or copies of any of our previous client memoranda, please contact John S. D'Alimonte (212-728-8212, jd'alimonte@willkie.com), Yaacov M. Gross (212-728-8225, ygross@willkie.com), Jeffrey S. Hochman (212-728-8592, jhochman@willkie.com), or the partner who regularly works with you.

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July 31, 2002