

## CEO and CFO Certifications and New Filing Deadlines for Annual and Quarterly Reports

On August 29, 2002, the SEC published rules implementing the CEO and CFO certification requirement of Section 302 of the Sarbanes-Oxley Act of 2002 (<http://www.sec.gov/rules/final/33-8124.htm>). On August 27, 2002, the SEC also approved rules, which have not been published, shortening filing deadlines for quarterly and annual reports of most U.S. public companies and requiring disclosure about access to SEC reports on company websites.

### CEO and CFO Certifications

The Sarbanes-Oxley Act includes two separate provisions - Sections 302 and 906 - requiring certification by CEOs and CFOs of periodic reports of public companies. Section 906 was effective on July 30, 2002, when the President signed the act, and most companies had their first experiences complying with this section when they filed their recent quarterly reports. The SEC's new rules to implement Section 302 became effective on August 29, 2002.

### New Section 302 Certification Rules

The SEC's new rules for Section 302 - Rules 13a-14 and 15d-14 under the Securities Exchange Act of 1934 - require each of the CEO and CFO to make a set of certifications (see box) with any quarterly or annual report (including any amendment to such reports or transition reports) filed after August 29, 2002.

#### *Section 302 Certification*

The executive must certify that

- he or she has reviewed the report;
- based on his or her 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 the report;
- based on his or her 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 the report;
- both the CEO and CFO are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act rules) for the company and have
  - designed such disclosure controls and procedures to ensure that material information relating to the company, including its consolidated subsidiaries, is made known to the CEO and CFO by others within those entities, particularly during the period in which the report is being prepared;
  - evaluated the effectiveness of the company's disclosure controls and procedures as of a date within 90 days prior to the filing date of the report (the "Evaluation Date"); and
- presented in the report their conclusions about the effectiveness of the disclosure controls and procedures based on their evaluation as of the Evaluation Date;
- both the CEO and CFO have disclosed, based on their most recent evaluation, to the company's auditors and audit committee
  - all significant deficiencies in the design or operation of internal controls which could adversely affect the company's ability to record, process, summarize and report financial data, and have identified for the company's auditors any material weaknesses in internal controls; and
  - any fraud, whether or not material, that involves management or other employees who have a significant role in the company's internal controls; and
- both the CEO and CFO have indicated in the report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of their most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Covered Reports. Certification is required for any quarterly or annual report. This includes Forms 10-K, 10-Q, 10-KSB and 10-QSB for U.S. companies, Forms 20-F and 40-F for foreign companies and Form N-SAR for registered investment companies. Certification is also required for amendments to any covered report (whether the covered report was filed before or after August 29), and for transition reports. Section 302 certification is not required for Forms 8-K and 6-K or proxy statements.

The SEC has amended its periodic reports to provide a certification form. This certification must be signed exactly as set forth in the appropriate form and cannot be executed on behalf of the certifying officer with a power of attorney.

“Fairly Presents.” Certifying executives must state that financial statements and other financial information “fairly present,” in all material respects, the financial condition, results of operations and cash flows of the company. The SEC has made clear that the absence of the words “in accordance with GAAP” was intentional, which means that the certified report must include all information necessary to understand the complete financial condition of the company whether or not such disclosure is required by GAAP. This certification is required with respect to both financial statements “and other financial information.” As a result, the certification extends beyond the financial statements to cover footnotes, management’s discussion and analysis and any other financial information included in the report.

Disclosure Controls. The new rules, which introduce the new term “disclosure controls and procedures” to securities law, require an overall system of disclosure controls and procedures to ensure that information required to be disclosed under the Exchange Act is made known to management, including the CEO and CFO, as appropriate to allow timely decisions regarding disclosure. While all companies have disclosure systems of some sort, it will be important to evaluate these systems in the context of the new certification requirements. Companies will want to assess whether controls and procedures adequately capture and communicate information to those responsible for preparing reports. There is no universal prescription for disclosure controls and procedures - they will vary by company. Nevertheless, the SEC does recommend that companies form a committee, which would report to senior management, responsible for evaluating the materiality of information and determining disclosure obligations. The SEC suggests that this committee include at least the controller, general counsel, principal risk management officer and chief investor relations officer.

Executives at many companies may not currently be comfortable certifying that they have “designed” their system of disclosure controls and procedures. The term “designed,” which comes from the Sarbanes-Oxley Act, is unfortunate in that it misapprehends either a sensible or likely use of executive talent. Nonetheless, it is logical to assume that neither Congress nor the SEC intended to require micromanagement and that certifications regarding design of systems implicitly include delegated design and implementation of such systems. Executive certification with respect to disclosure controls only applies to periods ending after August 29, 2002.

Investment Companies and Asset-Backed Issuers. The SEC has also adopted a new rule under the Investment Company Act, requiring a Section 302 certification for investment companies that are required to file reports under the Exchange Act. This rule requires the principal executive and financial officers to certify each semi-annual report on Form N-SAR, as well as the financial statements on which the report is based. The SEC has announced that it intends to propose rules expanding the Section 302 certification requirement to cover all registered investment companies and a new shareholder

report on Form N-CSR, and expanding disclosure controls requirements to cover all disclosure documents (including filings under the Securities Act and Investment Company Act).

Asset-backed issuers, which operate under a modified disclosure regime, are subject to Section 302. Because the reporting rules for asset-backed issuers are significantly different than for other companies, the SEC has created a specially tailored certification to be used by asset-backed issuers. A form of this certification can be found on the SEC's website at <http://www.sec.gov/divisions/corpfin/8124cert.htm>. This certification must be signed by the trustee of the trust (if the trustee signs the report), or the senior officer in charge of securitization of the depositor (if the depositor signs the report).

### Section 906: Compliance Questions

Section 906 of the Sarbanes-Oxley Act requires the CEO and CFO to certify any periodic report containing financial statements. The certification must state that the report

- fully complies with the requirements and rules for the report (as discussed further below); and
- fairly presents, in all material respects, the financial condition and results of operation of the company.

In addition to containing certification language that is different than Section 302, this provision of the Sarbanes-Oxley Act is subject to criminal sanctions.<sup>1</sup>

Many people have asked the SEC to harmonize the differences between Sections 302 and 906, but to date it has said that because Section 906 is a criminal law, the provision is beyond the agency's jurisdiction. The SEC staff is in discussions with the Department of Justice over this issue.

### Covered Reports

- *U.S. Companies.* Certification under Section 906 is required for any "periodic report containing financial statements" filed with the SEC. Thus, an annual or quarterly report, such as a Form 10-K or 10-Q, clearly requires a Section 906 certification. Some have questioned whether a Form 8-K that contains financial statements would require a Section 906 certification. Forms 10-K and 10-Q, which have as their respective titles "annual report" and "quarterly report," are generally referred to as "periodic reports," and Form 8-K is entitled "current report." As a result, it is reasonable to take the position that a Form 8-K, even if it includes financial statements, is not subject to Section 906. There is also some reason to believe that Congress intended this provision to work in tandem with Section 302, which clearly is only applicable to annual and quarterly reports. We are comfortable, at this time, with the conclusion that a Form 8-K is not a "periodic report," but note the possibility of continued clarification in this area. For this reason, we recommend that companies discuss with counsel the potential certification requirements before filing any Form 8-K including financial statements.
- *Foreign Companies.* Certification under Section 906 is also required for periodic reports of foreign companies - annual reports on Form 20-F or 40-F - a fact

<sup>1</sup> Section 906 provides for a fine of up to \$1 million or imprisonment of up to 10 years if an executive certifies a report "knowing" that the certification is false. A "willfully" knowing false certification can lead to a fine of up to \$5 million or imprisonment of up to 20 years.

which has drawn adverse attention of the international business community. A Section 906 certification should not be required for a Form 6-K, because Form 6-K is “furnished” to the SEC, not “filed.”

Qualifications of Certification. Although Section 906 does not state that the certification is to be qualified, the penalties for violation only apply when a false certification is made knowingly. We therefore understand the growing practice of qualifying the Section 906 certification by the phrase “to my knowledge,” to make clear, for purposes of traditional civil securities law liability, that the statement made by the executive is limited to the executive's knowledge.

We have also seen some executives further qualify the Section 906 certification by inserting the phrase “as of the date of this report” or by indicating that the certification is made in a corporate capacity rather than a personal capacity. While these qualifications probably do not hurt, in a legal sense, they are also unlikely to help. The executive's certification should be understood as speaking as of the time of its signing, and the capacity in which an executive certifies a report would affect neither civil nor criminal liability. In light of market demands for corporate responsibility for reporting, we recommend against legally ineffective qualifications that give an appearance of an attempt to equivocate or limit the genuineness of the certification.

“Fully Complies.” The Section 906 certification requires the certifying executive to state that the report “fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934.” These sections of the Exchange Act are the provisions under which the SEC issued Forms 10-K and 10-Q (among others), and the rules that determine what issuers are required to include in those reports. At first this may seem a challenging standard to certifying executives, in that an executive necessarily relies on legal counsel to determine compliance with form requirements under the Exchange Act. However, executives may take some comfort in the fact that, as discussed above, penalties under Section 906 only apply where the certification is knowingly false.

Methods of Compliance. Certification under Section 906 must “accompany” the report being certified. Three methods of filing the certification have emerged that should satisfy the “accompany” requirement.

- *Signature Page* - The certification can be integrated into the signature page of the report.
- *Exhibit* - The certification can be attached as an exhibit to the report being certified.
- *EDGAR Correspondence* - The certification can be filed as accompanying correspondence through the SEC's electronic filing system (EDGAR).

In the current environment, the primary concern for many companies is how to give the certification the most prominence. Companies choosing to file the certification as EDGAR correspondence should be aware that EDGAR correspondence cannot be viewed by the public.<sup>2</sup> For this reason, some prefer to include the certification with the publicly filed report either on the signature page or as an exhibit.

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<sup>2</sup> EDGAR correspondence should satisfy the “accompany” requirement because it can be viewed by the SEC and is transmitted along with the report.

Alternatively, when transmitting the certification as correspondence through EDGAR, some prefer also submitting it with a Form 8-K under Item 9. This method is thought to eliminate civil liability for the certifying executive under Section 18 of the Exchange Act and, if the company has active registration statements, Section 11 of the Securities Act. But a false certification could still be subject, in the case of Section 906, to the criminal penalties discussed above, and in any case to liability under Rule 10b-5. We do not disagree that filing the certification on Form 8-K under Item 9 may save the executive from some civil liability in the event of a false certification; however, we think it is important to understand that the liability saved with this strategy is likely to be incremental.

### **Back-up Certification By Employees**

Prior to certifying reports, some executives have adopted the practice of requiring back-up certifications from employees who participate in preparing the reports. While many executives find back-up certifications to be helpful to ensure that employees pass along concerns about disclosure issues, or to encourage a sense of personal responsibility among employees, many other executives find that back-up certifications, which are not legally required, have drawbacks.

Back-up certifications require a new layer of paperwork and administrative support. Also, if too many employees are required to provide back-up certifications, the process can become overly formulaic and lose value. On the other hand, an employee who is not required to provide a back-up certification may feel that his or her importance is not significant.

The real benefit of back-up certifications is that they provide an executive tangible evidence of the basis for his or her knowledge at the time of a certification. Further, back-up certifications encourage a sense of personal responsibility among employees involved in preparing financial statements and reports. Although back-up certifications are not appropriate for every company, on balance, we believe they are likely to be useful, particularly for large companies.

### **Practices Continue to Evolve**

CEOs and CFOs at most public companies have now had at least one experience with certification under Section 906. At the largest public companies, executives were also recently required to attest as to past reports. With the new rules published on August 29, the new certification regime is in place. Going forward, each annual and quarterly report will require two types of certifications - one under Section 302 and one under Section 906. Practices will undoubtedly continue to evolve, and future SEC rulemaking is not out of the question. As discussed above, the SEC is currently reluctant to comment on Section 906, a criminal statute. It is possible, however, that in the future, as dual (and inconsistent) certification presents challenges to executives and issuers, regulators will become more willing to harmonize these two certification provisions.

**Accelerated Filing of Annual and Quarterly Reports; Website Access**

*As originally published, this memorandum included a summary of the accelerated filing and website access disclosure ruled based on descriptions of those rules by SEC staff and Commissioners at the SEC's open meeting on August 27, 2002 and the SEC's press release regarding that meeting. The final rules were issued on September 5, 2002. As a result, we have updated the material that originally appeared below in a subsequent memorandum discussing the final accelerated filing and website access disclosure rules, which may be found at <http://www.cov.com/publications/download/oid6452/305.pdf>.*

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The new rules discussed above may seem challenging, particularly as they are viewed by many as pulling in different directions. CEOs and CFOs are asked to take greater responsibility for the accuracy of reports, while being given less time to complete them. We cannot resolve this incongruity, but we believe that certifications will eventually cease to be front page news. As companies grow comfortable with new disclosure provisions and systems, we expect shortened deadlines for annual and quarterly reports to become manageable.

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