

# Interview

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## CEOs and CFOs Should Review Procedures for Filing Reports With SEC in Light of New Certification Requirement

**E**ditor's Note: Mark S. Bergman, Esq., is the head of the Securities Group at Paul, Weiss, Rifkind, Wharton & Garrison and is based in the firm's London office. Richard S. Borisoff, Esq., a partner in the firm's New York office, has particular expertise in general corporate counseling and works extensively in the securities area. They recently answered questions from BNA concerning the new requirement by the Securities and Exchange Commission that chief executive officers and chief financial officers of the largest corporations must certify their company's financial statements.

**BNA:** In general, which companies are affected by the June 27 order issued by the SEC concerning certifications of reports filed with the agency and what are those companies required to do as a result of the order?

**Bergman and Borisoff:** The SEC selected 947 reporting companies whose CEOs and CFOs will be required to provide personal certifications. The reporting companies themselves are not required to do anything. The certifications will address:

- the accuracy and completeness of each company's latest periodic reports under the Securities Exchange Act of 1934 (covering the most recent 10-K and any intervening 10-Qs, 8-Ks and definitive proxy materials, and any amendments thereto), and

- consultation with the audit committee concerning the contents of such certifications.

Each officer must file a written certification, under oath, that to the best of his or her knowledge, based upon a review of the covered reports, and, except as corrected or supplemented in a subsequent covered report:

- no covered report contained an untrue statement of a material fact as of the end of the period covered by

such report (or in the case of a report on Form 8-K or definitive proxy materials, as of the date on which it was filed); and

- no covered report omitted to state a material fact necessary to make the statements in the covered report, in light of the circumstances under which they were made, not misleading as of the end of the period covered by such report (or in the case of a report on Form 8-K or definitive proxy materials, as of the date on which it was filed).

Alternatively, each such officer must file a statement in writing, under oath, describing the facts and circumstances that would make the statements in such certification incorrect.

In addition, in either case, the officers each must further declare in such certification or statement, under oath, whether or not the contents of the certification/statement have been reviewed with the company's audit committee or, in the absence of the audit committee, the independent members of the company's board of directors.

**BNA:** Do the statements required to be filed with the SEC have to be filed manually (i.e., a paper copy of the statement delivered to the SEC) or is there a procedure for filing the statements electronically?

**Bergman and Borisoff:** The certifications can only be filed in paper; they cannot be filed electronically via EDGAR.

**BNA:** How does the SEC intend to make these statements available to the general public?

**Bergman and Borisoff:** The SEC staff has indicated that the filed certifications are likely to be posted on the SEC's website.

**BNA:** What procedures do you suggest the senior officers follow before

filing the required statements with the SEC?

**Bergman and Borisoff:** The senior officers should have had in place, at the time of the filing of the original reports being certified, procedures relating to the reporting requirements of various levels of employees of the company, which procedures are designed to ensure that material issues relating to financial statement decisions are brought to the attention of, and ultimately made by, the CFO and CEO, or made by the CFO and approved by the CEO.

Section 13(b) of the Exchange Act, which is often cited in restatement cases as a basis for liability, requires reporting companies to keep accurate books and records and maintain proper internal accounting controls. At the time of the filing of the certifications, the CEO and CFO should review those procedures in detail to make sure they were in place and were followed at the time of the filing of the original reports.

Since these are one-time certifications which will have a high level of public attention, it would probably be best practice for the CEO and CFO to review in detail each material accounting decision made at the time of the filing of the original reports and determine whether those decisions continue to be appropriate at this time.

The CEO and CFO should also review the certifications as well as the procedures followed in preparing the original reports, with the audit committee, as a matter of good practice and to be in a position to make the additional certifications to the SEC.

To the extent that the appropriate procedures were not in place at the time of the original reports or that the CEO and CFO were not providing the

appropriate level of scrutiny of those reports at that time, a thorough reexamination of the financial statements may have to be conducted to allow the CEO and CFO to file the required certifications. Due to the short time frame for calendar year-end companies (for which the certification will be required by Aug. 14), a decision to conduct such a reexamination must be made very quickly.

**BNA:** Do you foresee any situations in which a senior officer would file a statement with the SEC and indicate that the contents of the statement were not reviewed with the corporation's audit committee (or independent directors if the company does not have an audit committee)?

**Bergman and Borisoff:** We can see no valid reason why a CEO or CFO would decline to review the contents of the certifications with the audit committee. Given the tremendous attention being given to proper roles of boards of directors, generally, and to audit committees, in particular, and the scrutiny of the manner in which such roles have (and should have been) discharged, failure to consult with those charged with overseeing compliance with the securities laws would be a tremendous mistake.

**BNA:** Do you anticipate that there will be any situations in which the statement of the CEO for a corporation will differ from the statement of the CFO for that same corporation?

**Bergman and Borisoff:** We expect that the senior officers will be able to make an affirmative certification.

In contrast to the certifications proposed on June 17 for all domestic reporting companies, which call for certification that to the certifying officer's knowledge, the information in the report is true in all important respects and that the report contains all information about the company of which the officer is aware that he or she believes is important to a reasonable investor, the general standards for disclosure in reports filed under the Exchange Act and the certifications (announced on June 27) in respect of such reports are the same.

Reports are required to comply with the form requirements (including the items cross-referenced in Regulation S-K) and to include, as specified in Rule 12b-20 of the Exchange Act, "[i]n addition to the information expressly required to be included in a statement or report, . . . such further material information, if

any, as may be necessary to make the required statements, in the light of the circumstances under which they are made, not misleading." In addition, the standards for liability under Rule 10b-5 include the making of any untrue statement of a material fact or the omission "to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading."

A company's 10-K would have been signed by the CEO and the CFO. The certification in respect of each report speaks as of the end of the period covered by the report; the standard for liability could extend past that point to the date of filing, but certainly covers the end of the period covered by the report.

If the CEO and the CFO were able to sign the 10-K, they should be able to sign the certification in respect of the 10-K.

Although the CFO must sign the 10-Q, the CEO may have signed as well. The CEO may have liability under Rule 10b-5 even if he or she had not signed the 10-Q. In any event, one would expect companies to have procedures in place for the CEO to sign off on quarterly filings. So again, one would expect that both senior officers had the appropriate level of comfort at the time the 10-Qs were filed. Disclosure in current reports and proxy materials is likely to be more straightforward, and should not give rise to certification issues.

**BNA:** The text of the required statement, as set forth by the SEC, refers to an untrue statement of a "material" fact, or the omission of a "material" fact in a covered report. If, when preparing to file the statement, it is discovered that some facts were untrue or omitted, what analysis should be used in deciding whether or not one or more of those facts was "material"?

**Bergman and Borisoff:** As to what information is material, this is the type of analysis that is regularly undertaken when preparing disclosure to be included in an SEC registration statement in compliance with the Securities Act of 1933 or periodic report filed with the SEC under the Exchange Act.

The standard of materiality, as set forth in various U.S. Supreme Court cases, encompasses information as to which there is a substantial likelihood that a reasonable investor would consider important in making an investment decision. To be mate-

rial, there must be a substantial likelihood that a fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available.

**BNA:** If it is determined that a material fact was untrue in a covered report or was not included in such report, how does a corporation correct that?

**Bergman and Borisoff:** A reporting company can always amend a report by filing an amendment (e.g., a Form 10-K/A).

**BNA:** Do you anticipate any situations in which senior officers might file statements explaining why they can not state that the covered reports are materially truthful and complete?

**Bergman and Borisoff:** No. If the senior officers discover that the covered reports do not comply with the standards of the certification, the company generally would have an obligation under the Exchange Act to correct those reports immediately. In this case, a duty to correct is likely to be triggered by reason of the senior officers learning that prior statements were misleading when made and the likelihood that the marketplace would be deemed to be continuing to rely on the misleading information (because the current financial statements are misleading, because past statements are misleading and such past misleading financial statements are deemed republished in current financial statements, or because past misleading financial statements have an effect on subsequent periods).

Such correction should be made before the certification is required and, if made, would allow each of the senior officers to make the certification.

If the senior officers were to file statements explaining why they cannot sign the certifications, they would in effect be admitting that the company's filings do not comply with the disclosure standards under the Exchange Act.

One interesting question is presented where the current CEO or CFO are not the same individuals who were in place at the time the relevant reports were prepared and filed with the SEC.

**BNA:** What is the liability exposure of a senior officer if the statement he or she makes under oath concerning the accuracy and completeness of the reports that were filed with the SEC turns out to be false?

**Bergman and Borisoff:** The SEC issued its order under Section 21(a)(1) of the Exchange Act, which gives it

the authority to investigate whether any person has violated, is violating, or is about to violate the Exchange Act and to require statements under oath as to the facts and circumstances concerning the matter being investigated.

The SEC could pursue the officers for false statements made to it under oath. In the press release announcing the certifications, the SEC stated that officers who make false certifications would face personal liability.

If the certifications are false and the senior officers are implicated in the conduct that gave rise to claims that the reports were false and misleading, there is a good chance that the SEC would bring an enforcement action against the company and the officers for materially false and misleading SEC disclosure. The false certifications would be additional elements of the complaint.

In restatement cases, the SEC may simply pursue the company. It generally will bring an action alleging violations of Sections 10(b), 13(a), and 13(b)(2)(A) and (B) of the Exchange Act, and Rules 10b-5, 12b-20, 13a-1, and 13a-13 thereunder. Section 13(a) requires reporting companies to file annual and quarterly reports, and implicit in these rules is the requirement that the reports accurately reflect the financial condition and results of operations of the issuer.

As noted previously, Rule 12b-20 requires the inclusion of additional material information necessary to make the required statements not misleading. Section 13(b) requires issuers to keep accurate books and records and maintain proper internal accounting controls. No showing of scienter is necessary to establish a violation of Section 13(a) or 13(b). The SEC may settle for a permanent injunction against the company, or seek civil penalties and/or disgorgement of ill-gotten gains from the alleged conduct.

In the case of egregious conduct, the SEC can, under Sections 21(d) and (e), in addition to, or in lieu of, charging the company, pursue senior officers deemed responsible for the company's conduct under Section 10(b) and Rules 10b-5, 13b2-1 (for falsification of accounting records), 13b2-2 (for false or misleading statements or material omissions made to an accountant in connection with an audit or the preparation of an SEC report) and 13b-5 (circumventing internal accounting controls), and for aid-

ing and abetting the company's violations of the Exchange Act (for filing false and misleading reports and/or maintaining false and misleading books and records and failing to maintain a system of internal accounting controls). Such officers might also face controlling person liability under Section 20(a) of the Exchange Act for failure to exercise due care in supervision of the company's accounting practices.

The SEC could seek in respect of the officers an injunction, civil penalties, and/or disgorgement of ill-gotten gains from the alleged conduct (e.g., performance bonuses), as well as a court-ordered bar from serving as an officer or director of another public company (under Section 21(d)(2)).

Senior officers might also face criminal charges in connection with fraudulent activity. Such officers could also face private actions under the anti-fraud provisions of the Exchange Act.

**BNA:** The SEC order issued on June 27 seems to require that the CEO and CFO make only one filing with the commission. Do you anticipate that an expanded certification requirement will be forthcoming from the SEC?

**Bergman and Borisoff:** These certification requirements appear to be a one-time event. The certifications are triggered by the filing of the next Form 10-K or 10-Q (which for calendar-year companies will be the quarterly report for the quarter ended June 30, due Aug. 14). The requirements have been put into place, without notice or public comment, by a regulator that is on the defensive politically and is trying to convince the investing public (and Congress) that, in spite of the recent wave of allegations of fraud and massive corporate restatements, the largest U.S. public companies have not violated their disclosure obligations under the securities laws.

These certifications were announced only 10 days after the SEC proposed certifications pursuant to which CEOs and CFO of all domestic reporting companies would be required to certify, with respect to the company's quarterly and annual reports, that:

- he or she has 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 that he or she believes is important to a reasonable investor (or, in the case of a quarterly report, important to a reasonable investor in light of the subjects required to be covered by a quarterly report) as of the last day covered by the report.

These requirements would be accompanied by a separate requirement that each domestic reporting company maintain procedures to provide reasonable assurance that the company is able to collect, process, and disclose the information required to be included in annual, quarterly, and current reports by the Exchange Act. In addition, before filing the Form 10-K, the company would be required to evaluate the effectiveness of the design and operation of these procedures under the supervision of management and ensure that those conducting the evaluation communicate the results of the evaluation to the principal executive officer, the principal financial officer, and the board of directors.

The company's principal executive officer and principal financial officer would have to review the annual evaluation and then certify in the company's annual report that they have reviewed the results of the evaluation.

This earlier proposal has raised a variety of questions regarding the standards for the certification and the potential impact of the certification requirement. Does the certification requirement implicitly expand the scope of line item disclosure under the Exchange Act? Does it create new standards of materiality? Does it create additional bases of liability for senior officers? Will the certifications lead to more litigation? One can expect that the SEC will receive a significant number of comments during the 60-day comment period.

It thus remains to be seen what form these general certifications will take, but the messages are clear: First, the senior officers of U.S. reporting companies will be required to personally provide the investing public with some level of comfort with respect to the companies' Exchange Act reports. Second, such companies will need to critically review and where necessary augment their practices and procedures for the preparation of Exchange Act reports in order to give comfort to the marketplace (and to the officers who will be required to sign certifications).