

**NEW SEC OATH REQUIREMENTS FOR CEOs AND CFOs
REGARDING RECENT EXCHANGE ACT FILINGS**

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On June 27, 2002, the Securities and Exchange Commission (the "SEC") issued an order (the "Order") requiring the chief executive officer ("CEO") and the chief financial officer ("CFO") of 945 U.S. publicly traded companies to file with the SEC sworn statements regarding the accuracy and completeness of their companies' most recently filed Form 10-K and other subsequently filed periodic reports and definitive proxy statements. The affected companies (the "subject companies") are those having revenues during the last fiscal year of more than \$1.2 billion and identified on a list available at www.sec.gov.

Although the Order requires only a one-time sworn submission, the SEC had earlier proposed a rule, which is still pending, that would require a similar type of certification from CEOs and CFOs of *all* public companies in connection with *future* annual and quarterly SEC filings.¹ We have previously circulated a memorandum dated June 27, 2002, captioned "SEC Proposes New Rules Relating to 8-K Disclosure and Officer Certifications" on this subject.

This memorandum summarizes the terms of the Order, outlines the implications of the Order for officers' civil and criminal liability, and reviews the procedures that CEOs and CFOs may wish to consider prior to submitting their sworn statements.

THE ORDER

The Order requires CEOs and CFOs of the subject companies to file separate statements under oath that, to the best of the officer's knowledge, each of the company's "covered reports" is true in all material respects and does not contain any material omissions. The Order defines "covered reports" as the company's most recent annual report on Form 10-K; all quarterly

¹ See SEC Release No. 34-46079, dated June 14, 2002.

reports on Form 10-Q, current reports on Form 8-K, and proxy materials filed after the filing of the Form 10-K; and any amendments to the foregoing. If an officer is unable to make such a statement, such officer must submit a sworn statement describing the facts and circumstances that would make such a statement incorrect. In addition, the sworn statement must indicate whether the officer has reviewed the statement with the company's audit committee or, if there is no audit committee, with the company's independent directors. Except as corrected or supplemented in a subsequent covered report, the relevant date for the accuracy and completeness of a covered report is the end of 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 they were filed). A copy of the required form of sworn statement is attached.

The sworn statements are due by the close of business on the first date a Form 10-K or Form 10-Q of the company is required to be filed on or after August 14, 2002. For a company with a quarter ended on June 30, 2002, the sworn statements must be filed no later than the close of business on August 14, 2002 – the last filing date for the company's next Form 10-Q.² The SEC has indicated that it will make all of the sworn statements public.

The SEC issued the Order pursuant to Section 21(a) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), which provides the SEC with investigative powers. The SEC indicated that the Order was being issued in connection with an "investigation to ascertain facts, conditions, practices and other matters relating to the financial statements and accounting practices of certain large publicly traded companies." One implication of the Order is that each of the subject companies could technically be considered the subject of an ongoing (albeit not particularly focused) SEC investigation.

According to the SEC, the purpose of its investigation is "to provide greater assurance to the Commission and to investors that persons have not violated, or are not currently violating, the provisions of the federal securities laws governing corporate issuers' financial reporting and accounting practices." Our view as to the purpose of the Order is also informed by the SEC's stated reasons for proposing its pending rule regarding CEO and CFO certifications of future periodic reports. Based upon the SEC's stated reasons for the pending rule, the Order is clearly designed to address concerns as to whether senior corporate officials devote sufficient attention to the preparation of their companies' public reports and to the internal processes that generate the data from which the reports are prepared.

² For companies with a fiscal quarter ended on May 31, 2002, the SEC has advised us that the sworn statements may be filed after the filing of the 10-Q required to be filed no later than July 15, 2002. Accordingly, under such circumstances, CEOs and CFOs need not defer filing their sworn statements until the filing of the 10-Q required to be filed by October 15, 2002.

**CURRENT AND NEW
SIGNATURE REQUIREMENTS**

Under current requirements, the CEO, the CFO, the principal accounting officer, and at least a majority of the company's board of directors must sign annual reports on Form 10-K, while the CFO or principal accounting officer must sign its quarterly reports on Form 10-Q. These signatures are not given under oath. The officers sign in their capacities as officers and/or as the "duly authorized" agents of the registrant.

The Order requires a new one-time filing by both the CEO and CFO attesting to the accuracy and completeness of the company's covered reports. The statement must be made under oath and to "the best of the officer's knowledge." The Order specifically requires the officer to indicate whether he or she has reviewed the contents of the sworn statement with the company's audit committee or, in the absence of an audit committee, the company's independent directors. The effect of requiring audit committee review of the sworn statements is to require the audit committee to review all portions of the covered reports, rather than only the financial information included in those reports.

**IMPLICATIONS OF THE
ORDER FOR OFFICER LIABILITY**

The SEC, in connection with issuing the Order, has not expressed a view as to whether the sworn statements expose a CEO or CFO to increased liability. Nonetheless, we believe that the Order potentially increases an officer's exposure to criminal prosecution and diminishes an officer's defenses to claims of civil liability.

Under existing law, officers may be subject to criminal liability for "willingly and knowingly" making a false statement in a periodic report or proxy statement, "knowingly and willfully" making a false statement to any federal department or agency, knowingly transmitting false statements through interstate commerce as part of a fraudulent scheme (mail fraud and wire fraud) and aiding and abetting another's crime (whether securities fraud, false statements, mail fraud or wire fraud). The Order expands an officer's potential exposure to criminal prosecution by subjecting the officer to potential charges of perjury (false statement under oath) and obstruction of justice (impeding any investigation pursuant to the Order or otherwise).

In terms of civil liability, an officer's verification that he or she was personally involved in reviewing and approving the periodic filings may diminish the defenses available to claims

made under the Exchange Act, including Section 10(b) (and Rule 10b-5 promulgated thereunder). For example, a CEO or CFO who personally attests to having reviewed the subject statements with the audit committee will have a less credible argument that he or she did not directly or indirectly induce the acts constituting the alleged violation.

RECOMMENDED PROCEDURES

The Order provides only minimal guidance as to the procedures that CEOs and CFOs need to follow in order to provide the sworn statements. Nonetheless, one can reasonably conclude that the requirement that the CEO and CFO make the sworn statements “to the best of their knowledge” imposes a level of reasonable inquiry upon these officers. The SEC takes the position that an officer or director may rely upon the company’s procedure for determining what disclosure is required only if such officer has a reasonable basis for believing that those procedures have resulted in full consideration of the relevant issues. *See* SEC Release No. 34-46079 (proposing certification by CEOs and CFOs of future filings; citing In re W.R. Grace & Co., SEC Release No. 34-39157 (Sept. 30, 1997)).³

Moreover, the Order mandates that the sworn statement set forth whether the officer has reviewed the contents of the sworn statement with the company’s audit committee or independent directors. The Order thus implicitly mandates a minimum level of due diligence that each signing officer read the covered reports and review their contents with the audit committee.⁴ This result is consistent with the SEC’s desire to address the recent examples of CEOs and CFOs disclaiming familiarity with the financial statements of the companies they manage.

We are mindful that our clients already engage in careful preparation and review of their Exchange Act filings. Nonetheless, in light of the fact that the sworn statement must be made to the best of the officer’s knowledge, we recommend that CEOs and CFOs take the following steps in preparing their sworn statements for submission to the SEC:

³ In that Release, the SEC also noted that procedures established to identify and address disclosure issues are effective only if individuals in positions to affect the disclosure process are vigilant in exercising their responsibilities.

⁴ As part of its Paperwork Reduction Act disclosure issued in connection with the Order, the SEC stated that it “estimate[s] that providing the requested information will take, on average, approximately 25 hours.”

- Review company procedures for collecting, processing and describing information (including non-financial information) required to be disclosed in the covered reports; and
- Assess the adequacy of these company procedures and ensure that they have been and are being properly executed.

In addition, depending on the facts and circumstances of a particular company, we recommend that CEOs and CFOs consider one or more of the following additional procedures in preparing their sworn statements:

- Review the covered reports with the management personnel responsible for preparing them and the heads or chief financial officers of the business units described in the reports. Areas on which the SEC has recently focused include revenue and expense recognition, off-balance sheet transactions, “related party” transactions by directors, officers and major shareholders with the company, reserves, pro forma reporting and disclosures regarding critical accounting practices.
- Review with the independent auditors their review of the interim financial statements pursuant to Statement on Auditing Standards No. 71.
- Review any negative comments about the company’s accounting practices by analysts or the financial press and evaluate how the comments were addressed by management, the company’s auditors and the audit committee.
- Review any issues and internal control concerns raised by auditors, including the independent auditor’s most recent management review letter, and any responses by management.
- Review any communications by employees or shareholders raising concerns about accounting, management or other issues and the company’s responses to such communications.
- To the extent that the covered reports include information regarding less than wholly-owned subsidiaries, review the procedures for incorporating the less than wholly-owned subsidiaries’ information in the reports.

In addition to these areas of potential review, CEOs and CFOs may want to consider requesting written certifications from those individuals who participate in the preparation of the covered reports and the heads or chief financial officers of the business units whose businesses are described in the reports. Such certifications are, however, not required by the

Order and companies will want to weigh the benefits of such certifications against the burdens of obtaining them.

We also recommend that CEOs and CFOs consult with the audit committee or its chairperson (or, if there is no audit committee, one or more independent board members) as to their views with respect to the adequacy of the procedures to be undertaken by the CEO and CFO in preparing their sworn statements prior to reviewing the contents of the sworn statements with the audit committee or independent board members. In that connection, CEOs and CFOs may wish to inform the audit committee (or independent board members) as to which of the recommendations set forth above they are employing in preparing their sworn statements, including the procedures for collecting, processing and describing information required to be disclosed in the covered reports.

The foregoing list of procedures is not exhaustive. We understand that every company has unique issues regarding its business accounting practices and financial presentation. We encourage you to call us for individualized consultation regarding the upcoming review process and the preparation of sworn statements. Specifically, you may wish to consult us concerning the issues raised by newly appointed senior officers, pending SEC investigations, or outstanding SEC comment letters on prior filings. Finally, we recommend that companies review their directors and officers insurance policies for any provisions that would require amendment in light of the Order and its new requirements.

Please contact your relationship partner or any of the partners listed on the next page if we can be of assistance regarding these important developments.

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