

DETERMINED TO BE AN  
ADMINISTRATIVE MARKING  
E.O. 12065, Section 8-102  
By JMV NARS, Date 5/2/2012

Circ. 8/16 for 8/27

Recommendation  
Approved by  
Commission

Sherry Stephen  
Supervisory Program Information Specialist

AUG 27 2002

August 16, 2002

5-0  
PGGAC

ACTION MEMORANDUM

**TO:** The Commission

**FROM:** Division of Corporation Finance *FR2BK*

**SUBJECT:** Certification of Disclosure in Companies' Quarterly and Annual Reports

**RECOMMENDATION:** That the Commission issue a release, substantially in the form of Attachment A, adopting new rules that would require issuer's principal executive and financial officers to certify the contents of quarterly and annual reports filed under the Exchange Act

**ACTION REQUESTED BY:** August 27, 2002

**SUNSHINE ACT STATUS:** Open Meeting

**REGULATORY FLEXIBILITY ACT STATUS:** The Draft Adopting Release includes a Final Regulatory Flexibility Analysis.

**COST-BENEFIT ANALYSIS:** The Draft Adopting Release includes a consideration of the new rules' costs and benefits.

**PAPERWORK REDUCTION ACT STATUS:** Paperwork Reduction Act filings will be submitted to the Office of Management and Budget in connection with these new rules.

**MAJOR RULE ANALYSIS:** We will consult with the Office of Economic Analysis as to whether the new rules constitute a major rule under the Small Business Regulatory Enforcement Fairness Act.

**NOVEL, IMPORTANT OR COMPLEX ISSUES:** None

DETERMINED TO BE AN  
ADMINISTRATIVE MARKING  
E.O. 12065, Section 6-103  
By *JMV* NARS, Date *5/2/2012*

II. Discussio.

1. Certification Requirement

New Rules 13a-14 and 15d-

**OTHER OFFICES OR  
DIVISIONS  
CONSULTED:**

Office of General Counsel -- (G. Prezioso, M. Mitchell, D. Fredrickson)  
Office of the Chief Accountant (S. Burke, M. Thompson)  
Division of Investment Management (P. Roye, B. Bullard, P. Cellupica)  
Office of Economic Analysis -- (J. Sokobin)

**PERSONS TO  
CONTACT:**

Elizabeth M. Murphy, Chief, Office of Rulemaking – ext. 2848  
Mark A. Borges, Special Counsel, Office of Rulemaking – ext. 1859

**I. Introduction**

On July 30, 2002, President Bush signed into law the Sarbanes-Oxley Act of 2002. Section 302 of the Act requires the Commission to adopt rules implementing specified statutory certification requirements for principal executive and financial officers by August 29, 2002, 30 days after the date of enactment. On June 14, 2002, the Commission had proposed to require a specified certification by an issuer's principal executive and financial officers. In addition, the Commission had proposed to require an issuer to maintain procedures to provide reasonable assurance that the issuer is able to collect, process and disclose the information required in the issuer's Exchange Act reports, and also to require annual review and evaluation of these procedures.

To satisfy the requirements of Section 302 of the Act, the Division of Corporation Finance has prepared a draft release adopting new Exchange Act Rules 13a-14 and 15d-14 that would require an issuer's principal executive and financial officers to provide the certification specified in Section 302 in each quarterly and annual report filed or submitted under either Section 13(a) or 15(d) of the Exchange Act. These new rules replace the comparable rules contained in the Commission's June proposals.

The draft release also adopts new Exchange Act Rules 13a-15 and 15d-15 that would require issuers to maintain a system of disclosure controls and procedures (as defined in new Exchange Act Rules 13a-14 and 15d-14) sufficient to provide reasonable assurance that an issuer is able to process and disclose the information required in its Exchange Act reports filed with the Commission. These rules complement the requirement that an issuer's principal executive and financial officers make specific statements in their certifications about establishing, maintaining and periodically evaluating the issuer's disclosure controls and procedures (a newly-defined term reflecting Section 302's concept of controls and procedures related to disclosure) by imposing a similar requirement on the issuer. These new rules are comparable to rules contained in the Commission's June proposals.

M. Thompson)

ezioso, M. Mitchell, D.

orporation Finance  
Disclosure in Companies' Quarterly and

DETERMINED TO BE AN  
ADMINISTRATIVE MARKING  
E.O. 12065, Section 6-103  
By *JMV* NARS, Date *5/2/2012*

**II. Discussion**

**1. Certification Requirement**

New Rules 13a-14 and 15d-14 require an issuer's principal executive and financial officers to certify in each quarterly and annual report filed or submitted under either Section 13(a) or 15(d) of the Exchange Act 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 in order to make the statements made, in light of the circumstances under which such statements were made, not misleading;
- 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 and results of operations of the issuer as of, and for, the periods presented in the report;
- he or she and the other certifying officers:
  - are responsible for establishing and maintaining "disclosure controls and procedures" (a newly-defined term reflecting Section 302's concept of controls and procedures related to disclosure) for the issuer;
  - have designed such disclosure controls and procedures to ensure that material information is made known to them, particularly during the period in which the periodic report is being prepared;
  - have evaluated the effectiveness of the issuer's disclosure controls and procedures within 90 days of the date of the report; and
  - have presented in the report their conclusions about the effectiveness of the disclosure controls and procedures based on the required evaluation;
- he or she and the other certifying officers have disclosed to the issuer's auditors and to the audit committee of the board of directors (or persons fulfilling the equivalent function):
  - all significant deficiencies in the design or operation of internal controls (a pre-existing term relating to internal controls regarding financial reporting) which could adversely affect the issuer's ability to record, process,

'ER'

DETERMINED TO BE AN  
ADMINISTRATIVE MARKING  
E.O. 12065, Section 6-102  
By JMV NARS, Date 5/2/2012

Content of

The certification required by  
The statement concerning the materi-  
that are covered by the statement mit  
"material" accuracy and completeness

summarize and report financial data and have identified for the issuer'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 issuer's internal controls; and

- he or she and the other certifying officers have indicated in the report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

2. Issuers and Reports Covered by Requirement

Section 302 of the Act states that the certification requirement is to apply to each company filing periodic reports under Section 13(a) or 15(d) of the Exchange Act. Accordingly, the new rules apply to the principal executive and financial officers of any issuer that files quarterly and annual reports with the Commission under either Section 13(a) or 15(d) of the Exchange Act, including foreign private issuers, banks and savings associations, issuers of asset-backed securities and small business issuers. The new rules require that the certification be included in annual reports on Forms 10-K, 10-KSB, 20-F and 40-F, quarterly reports on Forms 10-Q and 10-QSB and amendments to any of the foregoing reports.

Current reports on Forms 6-K and 8-K are not covered by the certification requirement. Disclosure controls and procedures, however, are required to be established, maintained and evaluated to ensure full and timely disclosure in all Exchange Act reports including current reports and proxy and information statements.

While the Commission's June proposals would not have applied to foreign private issuers, Section 302 of the Act makes no distinction between domestic and foreign issuers. Accordingly, the new rules apply the certification requirement to foreign private issuers filing annual reports on Form 20-F and Canadian issuers filing Form 40-F under our Multi-jurisdictional Disclosure System.

The new rules also would apply to registered investment companies, which file periodic reports pursuant to Sections 13(a) and 15(d) under the Exchange Act on Form N-SAR. The Division of Investment Management will be submitting a separate memorandum addressing the application of Section 302 of the Act to investment companies, and a draft release proposing to redesignate the reports that management investment companies are required to transmit to their security holders semi-annually under the Investment Company Act of 1940 as the periodic reports that meet their reporting obligations under Sections 13(a) and 15(d) of the Exchange Act.

management or other internal controls; and identified for the issuer's controls; and

ation Finance  
Disclosure in Companies' Quarterly and  
substantially in the  
would

DETERMINED TO BE AN  
ADMINISTRATIVE MARKING  
E.O. 12065, Section 8-102  
By *JMV* NARS, Date *5/2/2012*

3. Content of Certification

The certification required by Rules 13a-14 and 15d-14 contain several statements. The statement concerning the material accuracy and completeness of the periodic reports that are covered by the statement mirrors the existing statutory disclosure standards for "material" accuracy and completeness of information contained in reports.

The statement concerning the financial condition and results of operations of the issuer was not part of the Commission's June proposals. This statement is to provide assurances that an issuer's overall financial disclosure fairly presents, in all material respects, the issuer's financial condition and results of operations. The release makes it clear that this statement should be construed to mean that the financial information disclosed in a report, viewed in its entirety, meets a standard of overall material completeness and correctness that is broader than financial reporting requirements under generally accepted accounting principles.

Both of the foregoing statements are limited to the knowledge of the certifying officer. The release notes that this qualification is not meant to change the current duty of inquiry by corporate officers and directors in connection with the discharge of their duties.

PA The certification required by the new rules contains several, more detailed, statements concerning an issuer's "internal controls" and the ongoing oversight of these controls than were originally included in the Commission's June proposals. The rules differentiate between controls and procedures that address the quality and timeliness of disclosure and those that address an issuer's financial reporting and control of its assets, as currently embodied in Section 13(b) of the Exchange Act and Section 404 of the Act.

The new rules define "disclosure controls and procedures" to mean internal controls and other procedures of an issuer that are designed to ensure that information required to be disclosed by the issuer in the reports filed by it under the Exchange Act is collected, processed and disclosed, within the time periods specified in the Commission's rules and forms. These controls and procedures include, without limitation, internal controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports filed by it under the Exchange Act is communicated to the issuer's management, including its principal executive and financial officers, as appropriate to allow timely decisions regarding required disclosure

The certification required by the new rules refers to certain disclosures regarding both disclosure controls and procedures and internal controls that must be made in the reports in which the certification is contained. These disclosure requirements will be contained in new Item 307 of Regulation S-K, Item 307 of Regulation S-B and new disclosure items in Forms 20-F and 40-F.

DETERMINED TO BE AN  
ADMINISTRATIVE MARKING  
E.O. 12065, Section 6-102  
By *JMV* NARS, Date *5/2/2013*

form the basis for the disclosure controls:

V. Conclusion

Because the statements involving internal controls require the certifying officers to engage in certain specified actions, such as evaluating the effectiveness of the disclosure controls and procedures prior to the date of the report to which the certification relates, these statements will be required as part of the certification only with respect to any covered reports filed on or after the 90<sup>th</sup> day after effectiveness of the new rules.

The certification required by new Rules 13a-14 and 15d-14 must be in the specific form set forth in the related Exchange Act reports. The wording of the required certification may not be changed in any respect (even if the change would appear to be inconsequential in nature).

4. Disclosure Controls and Procedures

New Exchange Act Rules 13a-15 and 15d-15 require that an issuer establish (if it has not already done so) and maintain an overall system of disclosure controls and procedures that is adequate to meet its Exchange Act reporting obligations. These rules are intended to complement existing requirements for reporting companies to establish and maintain systems of internal controls with respect to their financial information.

As discussed in the Commission's June proposals, these controls and procedures are intended to cover a broader range of information than are covered by an issuer's internal controls related to financial reporting. For example, the controls and procedures should ensure timely collection and evaluation of information potentially subject to disclosure under the requirements of Regulation S-K or S-B and Forms 20-F and 40-F. The controls and procedures should capture information that is relevant to an assessment of the need to disclose developments and risks that pertain to the issuer's businesses. They also should cover information that must be evaluated in the context of the disclosure requirement of Exchange Act Rule 12b-20.

The release makes it clear that the new rules are entirely complementary to the objectives of Section 302 of the Act. While Section 302 requires an issuer's principal executive and financial officers to make specific statements in their certifications and to take the actions satisfying the representations made in the statements as to the issuer's disclosure controls and procedures, it does not directly address the issuer's obligations with respect to these controls and procedures. The new rules will ensure that an issuer also has a responsibility to maintain adequate disclosure controls and procedures, so that its principal executive and financial officers can supervise and review these periodic evaluations and report the results to security holders through the issuer's Exchange Act reports.

The new rules require the issuer, under the supervision of the principal executive and financial officers, to conduct an evaluation of the issuer's disclosure controls and procedures on a quarterly basis. While the new rules do not provide detailed procedures for such an evaluation, the evaluation must, at a minimum, address the matters specified by the rules. We expect that this evaluation would be carried out in a manner that would

Division of Corporation Finance  
Disclosure in Companies' Quarterly and Annual Reports

DETERMINED TO BE AN  
ADMINISTRATIVE MARKING  
E.O. 12065, Section 6-102  
By *JMV* NARS, Date *5/2/2012*

require the certifying officers to certify the effectiveness of the disclosure in the report to which the certification applies only with respect to the effectiveness of the new rules.

form the basis for the statements required by new Rules 13a-14 and 15d-14 regarding disclosure controls and procedures.

**V. Conclusion**

We believe that the new rules will lead to greater involvement on the part of corporate executives in the preparation of their companies' periodic reports and in the overall corporate reporting process. This should help restore investor confidence in the quality of the disclosure contained in these reports. For these reasons and since adoption will fulfill Congress' statutory directive with respect to the certification of Exchange Act periodic reports, the Division of Corporation Finance recommends that the Commission authorize the issuance of the attached release.

Attachment

Attachment A -- Draft Adopting Release

1101