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SEC Requires Additional CEO and CFO Certifications

Pursuant to the Sarbanes-Oxley Act of 2002 (the “Sarbanes Act”), the Securities and Exchange Commission (the “SEC”) issued final rules on August 29, 2002 requiring certifications signed by executives in annual and quarterly reports filed or submitted by public companies with the SEC. The rules also provide for new required information to be included in annual and quarterly reports concerning disclosure controls and procedures. These rules modify and finalize proposals of the SEC in June 2002 and incorporate the requirements of Section 302 of the Sarbanes Act. This Client Advisory updates and supplements the August 2002 ZAG/S&W LLP Client Advisory entitled “Certifications by Principal Executive Officers and Principal Financial Officers.”

Executive Certifications in Annual and Quarterly Reports

The SEC’s rules require certifications from principal executive officers and principal financial officers of public companies in each annual report (Form 10-K) and quarterly report (Form 10-Q).¹ The certifications are that:

1. The officer has reviewed the report being filed;
2. 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;
3. 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;
4. He or she and the other certifying officers are responsible for establishing and maintaining disclosure controls and procedures for the company, and they have:
 - (a) designed disclosure controls and procedures to ensure that material information related to the company, including its consolidated subsidiaries, is made known to them by others within those entities, particularly during the period in which the periodic report is being prepared;
 - (b) 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
 - (c) presented in the report their conclusions about the effectiveness of the disclosure controls and procedures based on their evaluation as of the Evaluation Date;

¹ The rules also apply to foreign private issuers filing or submitting annual reports on Form 20-F and Canadian companies filing or submitting annual reports on Form 40-F. Moreover, the SEC’s rules require similar certifications in some reports from certain entities subject to the Investment Company Act of 1940, and provide for modified certifications for companies that issue asset-backed securities and are permitted to file modified annual and other reports.

5. He or she and the other certifying officers have disclosed to the company's auditors and the audit committee of the board of directors (or persons fulfilling a similar function):
 - (a) 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
 - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the company's internal controls; and
6. 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.

The certifications will appear as part of the relevant report, following the signatures to the report. The certifications required by items 1, 2 and 3 above are effective immediately and must be included in annual and quarterly reports, including transition reports, filed or submitted after August 29, 2002. The certifications required by items 4, 5 and 6 must be included in annual and quarterly reports, including transition reports, filed or submitted for periods ending after August 29, 2002. Amendments to annual and quarterly reports must also contain new officer certifications.

The SEC has stated that no modifications should be made to the form of certifications, even if the changes are deemed inconsequential, and certifications may not be signed by officers pursuant to powers of attorney. These certifications are *separate and distinct* from the CEO and CFO certifications required by Section 906 of the Sarbanes Act, described in our prior Client Advisory on this subject. Until further SEC or Department of Justice guidance, each annual and quarterly report will contain two separate sets of officer certifications. Other than stating that Section 302 certifications are a separate set of certifications, the SEC has so far declined to provide any interpretative guidance on the certifications required by Section 906 of the Sarbanes Act.

The SEC believes that Congress intended the reference to a "fair presentation" to provide broad assurance that the financial information disclosed in the report is materially accurate and complete when viewed in its entirety, rather than merely covering presentation in accordance with GAAP. Specifically, the SEC stated in the adopting rules release that it envisions a "fair presentation" of financial condition, results of operations and cash flows to encompass "the selection of appropriate accounting policies, proper application of appropriate accounting policies, disclosure of financial information that is informative and reasonably reflects the underlying transactions and events and the inclusion of any additional disclosure necessary to provide investors with a materially accurate and complete picture of an issuer's financial condition, results of operations and cash flows." The SEC clarified that the certifications do not expand the scope of information required to be included in reports and that certifications are made in the context of each specific report's rules and form.

Disclosure Concerning Controls and Procedures

The rules add a new required section to each annual and quarterly report titled "Controls and Procedures." Under this new section, companies are required to disclose:

- in reports for periods ending after August 29, 2002, the conclusions of the company's principal executive officer and principal financial officer about the effectiveness of the company's *disclosure controls and procedures* based on their evaluation of those controls and procedures as of a date within 90 days of the filing date of the report; and
- in reports filed after August 29, 2002, whether there were significant changes in the company's *internal controls* or in other factors that could significantly affect those controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Disclosure Controls and Procedures

The rules require companies, including foreign private issuers, with securities registered pursuant to Section 12 of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), to begin immediately to maintain disclosure controls and procedures. Company management is also required to conduct reviews of its disclosure controls and procedures, under the supervision of its principal executive officer and principal financial officer, and these reviews should be done in a manner providing a basis for the new certifications.

“Disclosure controls and procedures” are controls and other procedures designed to ensure that information required to be disclosed by companies in their reports filed or submitted to the SEC pursuant to the Exchange Act is recorded, processed, summarized and reported within the time frames specified in the SEC’s rules and forms. Disclosure controls and procedures relate to *all* information, both financial and non-financial. They are broader than the more traditional concept of “internal controls” which relate only to financial information and would include, for example, non-financial risks and developments related to a company’s business. The SEC acknowledges that each company will have unique processes and systems that will evolve and improve over time.

Conclusion

Companies must review their existing internal policies and procedures in light of the new rules, revising and formalizing them to the extent necessary. We have provided a list and detailed discussion of recommended steps in our previous Client Advisory entitled “Certifications by Principal Executive Officers and Principal Financial Officers.” These steps broadly related to: revisiting existing disclosure policies, creating a disclosure review committee (which is specifically recommended by the SEC), convening formal disclosure review meetings, drafting and completing checklists each reporting period, using certification letters from executives or employees involved in the preparation of the underlying information in reports, extensive reviews with independent auditors and audit committees, and reviewing internal controls, policies and procedures. For a more comprehensive discussion of the topics covered in this Client Advisory or for assistance in developing any related policies or procedures, please contact the lawyer at ZAG/S&W LLP with whom you regularly consult, or the undersigned.

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Michael A. Mingoelli, Jr.
September 2002

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Because sound legal advice must necessarily take into account all relevant facts and developments in the law, the information you will find in this Advisory is not intended to constitute legal advice or a legal opinion as to any particular matter.