

# **ARNOLD & PORTER ADVISORY**

## **SEC Proposes Significant Changes to Quarterly, Annual, and Current Reports**

July 2002

---

The SEC recently issued important interpretations and proposed rule changes that are intended to enhance investor confidence in the quality of companies' public reporting. The latest rulemaking proposals would substantially expand current reporting on Form 8-K and require senior management to certify information contained in quarterly and annual reports. The following discussion covers these rulemaking proposals as well as recent proposals to accelerate filing deadlines for quarterly, annual, and current reports.

Since Enron, the SEC has issued three financial reporting releases and five rulemaking proposals – all focused on the clarity, completeness, and speed with which financial and other information is provided to the market.<sup>1</sup> Although we expect to see some changes to the various rule proposals, the substance of the rules likely will be adopted in one form or another. At the end of this rulemaking process, companies will be required to produce more information, more quickly. In anticipation of what the future holds, it is important to begin thinking about the impact of complying with these proposed rules. In addition, companies should begin testing the adequacy of their current controls and procedures to confirm that those controls and procedures will produce timely and accurate information.

The following discussion highlights key provisions of the proposed rules and discusses some of their practical implications.

### **WASHINGTON**

555 Twelfth Street, NW  
Washington, DC 20004-1206  
202.942.5000  
202.942.5999 Fax

### **NORTHERN VIRGINIA**

Suite 900  
1600 Tysons Boulevard  
McLean, VA 22102-4865  
703.720.7000  
703.720.7399 Fax

### **NEW YORK**

399 Park Avenue  
New York, NY 10022-4690  
212.715.1000  
212.715.1399 Fax

### **LOS ANGELES**

44<sup>th</sup> Floor  
777 South Figueroa Street  
Los Angeles, CA 90017-5844  
213.243.4000  
213.243.4199 Fax

### **CENTURY CITY**

17<sup>th</sup> Floor  
1900 Avenue of the Stars  
Los Angeles, CA 90067-4408  
310.552.2500  
310.552.1191 Fax

### **LONDON**

Tower 42  
25 Old Broad Street  
London EC2N 1HQ  
20.7786.6100  
20.7786.6299 Fax

### **DENVER**

Suite 4500  
370 Seventeenth Street  
Denver, CO 80202-1370  
303.863.1000  
303.832.0428 Fax

---

<sup>1</sup> A list of these financial reporting releases and rulemaking proposals is attached as an appendix to this discussion.

## PROPOSED CHANGES TO QUARTERLY AND ANNUAL REPORTS

### **A. *Acceleration of Quarterly and Annual Report Filing Deadlines***

The SEC has proposed to accelerate the filing deadlines for quarterly and annual reports. As proposed, the deadline for annual reports on Form 10-K would be shortened from 90 days to 60 days, and the proposed deadline for quarterly reports on Form 10-Q would be reduced from 45 days to 30 days.<sup>2</sup>

The application of the accelerated deadlines under the proposed rules would be limited to domestic reporting companies that are deemed “accelerated filers.” A company would be deemed an “accelerated filer” if it meets the following requirements:

1. the company has a public float of \$75 million as of a date within no more than 60 and no less than 30 days before the end of the company’s last fiscal year;
2. the company has been subject to reporting requirements of Section 13(a) or 15(d) of the Exchange Act for a period of at least 12 calendar months preceding the filing of the report; and
3. the company has filed at least one annual report pursuant to Section 13(a) or 15(d) of the Exchange Act.

### **Practical Implications of the Proposed Accelerated Filing Deadlines**

- Possible “accelerated filers” should reconsider chronologies and timelines currently in place for the preparation of periodic reports and make modifications necessary to ensure compliance with possible accelerated filing deadlines. For example, companies should consider that, in light of recent SEC actions relating to financial reporting and financial disclosures, audit committees will now need additional time to read and digest increasingly complex reports and disclosures and review them with management and independent auditors. The additional lead time needed by audit committees, as well as additional time for independent auditor reviews, argues for longer, not shorter periods to assemble, prepare and review reports, but companies may have to modify internal procedures in order to accommodate the proposed accelerated deadlines.
- A shortening of due dates for the filing of periodic reports creates a risk that more companies will file reports late or will need filing extensions. A company that is late in filing its periodic reports loses the availability of short-form registration statements for at least one year from the date of the late filing. A late filing also could render Rule 144 unavailable for sales of restricted and control securities, and make Form S-8 temporarily

---

<sup>2</sup> See SEC Proposed Rule: Acceleration of Periodic Filing Dates and Disclosure Concerning Website Access to Reports; Release Nos. 33-8089; 34-45741; (<http://www.sec.gov/rules/proposed/33-8089.htm>).

unavailable for resales of employee benefit plan securities. Although Rule 12b-25 will continue to be available for filing extensions, the SEC has traditionally looked on such extensions with disfavor and they can raise questions with investors. Repeated filing extensions likely will invite an SEC inquiry.

## **B. *Certification of Quarterly and Annual Reports***

**Certification of Disclosure.** The SEC has proposed requiring that, in each quarterly and annual report, a company's principal executive officer and principal financial officer each certify that<sup>3</sup>:

1. he or she has read the report;
2. to his or her knowledge, the information in the report is true in all ***important*** respects as of the end of the period covered by the report; and
3. the report contains all information about the company of which he or she is aware of and that he or she believes is ***important*** to a reasonable investor as of the end of the period covered by the report.

The certification also would contain a statement explaining that information would be considered "important to a reasonable investor" if there is a substantial likelihood that a reasonable investor would view the information as significantly altering the total mix of information in the report, and the report would be misleading to a reasonable investor if the information was omitted from the report.

In addition to the proposed certification requirement described above, the SEC has recently issued an order requiring that the chief executive officers and chief financial officers of 945 companies with annual revenues exceeding \$1.2 billion file separate sworn certifications regarding the accuracy of their companies' 2002 Exchange Act filings and their review of the certifications with their companies' audit committees.

**Certification of Internal Procedures.** In the same proposal, the SEC has also proposed a rule requiring that every company subject to reporting requirements establish and maintain systems of internal procedures to provide reasonable assurance that the company is able to collect, process, and disclose, in a timely manner, the information, including non-financial information, required to be disclosed in its periodic and current reports. Currently, public companies are required by statute to establish and maintain systems of internal controls with respect to their financial information.

---

<sup>3</sup> See SEC Proposed Rule: Certification of Disclosure in Companies' Quarterly and Annual Reports; Release No. 34-46079; (<http://www.sec.gov/rules/proposed/34-46079.htm>).

Prior to the filing of its annual report, each company would also be required to conduct an evaluation of the effectiveness of the design and operation of these procedures, and ensure that the company management conducting the evaluation communicates the results to the company's principal executive officer, principal financial officer, and the board of directors. In turn, the company's principal executive officer and principal financial officer would have to certify in the company's annual report that they have reviewed these evaluations.

## **Practical Implications of the Proposed Certification Requirements**

- By its terms, the proposed certification of disclosure is subjective in nature, and as a result, a principal executive officer or principal financial officer would not have to separately inquire as to information not known to him or her by virtue of the certification. However, the SEC does expect that a critical review of a report certifying officers would necessarily include inquiries where appropriate, for example, regarding disclosures that they do not understand or the materiality of information known to them.
- The SEC intends for the proposed certification of disclosure to reflect the current disclosure standards for "material" information, and believes that the certification follows the standard of "materiality" set out in case law. However, in using the "important to a reasonable investor" standard, there is a risk that a different standard may emerge. Moreover, while the certification speaks in terms of the officers' knowledge and belief, it seems likely that certifying officers will face more private actions alleging violations of Section 10(b) of the Exchange Act and Exchange Act Rule 10b-5.
- Companies should consider and adopt procedures for the gathering, analyzing, and disclosing of all information that is required to be included in its periodic and current reports. Important features to be included in such procedures include: the designation of individuals responsible for the gathering of information, perhaps through the creation of a committee responsible for considering the materiality of information and determining disclosure obligations on a timely basis; the identification of such individuals to all employees, officers and directors of the company; and a mechanism for the reporting of such information to management and others responsible for disclosure.
- In addition to the adoption of internal procedures for the gathering of information, companies must also establish a mechanism for the evaluation of such internal procedures and the reporting of the results of evaluations to senior management, including the company's principal executive officer and principal financial officer. While the reporting of results of evaluations serves the primary purpose of satisfying the certification requirement in an annual report, the SEC believes that the reporting of results of evaluations to the board of directors would also be beneficial to a company, and would aid individual directors in fulfilling their fiduciary responsibilities to the company.
- Companies might consider reviewing the scope of insurance coverage provided to directors and executive officers under existing policies and the scope of indemnification provided to directors and executive officers pursuant to their articles of incorporation and bylaws. Many of the proposed rules, in expanding the duties of certain officers and

board members, also expand the areas of potential liability that such officers and board members may face.

## **PROPOSED CHANGES TO CURRENT REPORTING**

### **A. *Addition of New Items to Current Reports on Form 8-K***

The SEC has proposed significant changes to Form 8-K to expand significantly the scope of events and items that would require a public company to file a current report. The SEC believes that the proposed new items represent events that presumptively have, or can have, such significance that timely disclosure is necessary for the market to perform properly and efficiently. The following is a list of the new disclosure items proposed to be added to Form 8-K<sup>4</sup>:

1. Entry into a material agreement not made in the ordinary course of business, *including letters of intent and other non-binding agreements*;
2. Termination of a material agreement not made in the ordinary course of business;
3. Termination or reduction of a business relationship with a customer that results in a loss of revenues of 10% or more of the company's consolidated revenues for its most recent fiscal year;
4. Creation of a direct or contingent financial obligation that is material to a company, whether or not the company is a party to the agreement;
5. Events triggering a direct or contingent financial obligation that is material to a company, including any default or acceleration of an obligation;
6. Exit activities including material write-offs and restructuring charges;
7. Any material impairment that a company's board of directors or authorized officers concludes should be recorded to one or more of the company's assets;
8. A change in a rating agency decision, issuance of a credit watch or change in a company outlook, provided that the rating agency notifies or otherwise communicates with the company and the company has provided information to the rating agency;
9. Movement of a company's securities from one exchange or quotation system to another, delisting of a company's securities from an exchange or quotation system, or a notice that a company does not comply with a listing standard;
10. Conclusion or notice that security holders no longer should rely on a company's previously issued financial statements or a related audit report; and

---

<sup>4</sup> See SEC Proposed Rule: Additional Form 8-K Disclosure Requirements and Acceleration of Filing Date; Release Nos. 33-8106, 34-46084; (<http://www.sec.gov/rules/proposed/33-8106.htm>).

11. Any material limitation, restriction or prohibition, including the beginning and end of lock-out periods, regarding a company's employee benefit, retirement, and stock ownership plans.

In the same release, the SEC has also proposed (a) to move reporting on unregistered sales of equity securities by a company and material modifications to rights of holders of a company's securities from Form 10-Q to Form 8-K; (b) to expand Form 8-K disclosure regarding the resignation of a director to require disclosure regarding the departure of a director for reasons other than a disagreement or removal for cause, the appointment or departure of a principal officer, and the election of new directors; and (c) to combine the Form 8-K disclosure regarding a change in the company's fiscal year with a new requirement to disclose any material amendment to a company's articles of incorporation or bylaws.

In a proposed rule released earlier this year, the SEC also proposed that required Form 8-K disclosure include certain director and executive officer transactions in company equity securities, the adoption, modification or termination of a contract, instruction or written plan for the purchase and sale of company securities by directors and executive officers intended to satisfy the affirmative defense conditions of Exchange Act Rule 10b5-1(c), and loans of money made to a director or executive officer made or guaranteed by the company or an affiliate.<sup>5</sup>

## **B. *Acceleration of Filing Deadlines for Current Reports on Form 8-K***

In addition to expanding the scope of items to be reported on Form 8-K, the SEC has proposed to shorten the deadlines for the filing of current reports on Form 8-K to two business days for almost all items that require reporting.<sup>6</sup> This significantly reduces the current Form 8-K deadlines of five business days or 15 calendar days, depending on the nature of the event requiring a Form 8-K filing. Under the proposed rule, deadlines for the filing of certain financial statements and exhibits would remain unchanged, although time would begin to run from the accelerated filing deadline.

The SEC has also proposed to create a safe harbor to accommodate companies that do not file Form 8-K reports in a timely manner despite making a good faith effort to file such reports. Under the safe harbor, a company would not be liable under Sections 13 and 15(d) of the Exchange Act for the failure to file a Form 8-K if:

1. On the Form 8-K due date, the company maintained sufficient procedures to provide reasonable assurances that the company is able to collect, process and disclose, within the specified time period the information required to be disclosed by Form 8-K; and

---

<sup>5</sup> See SEC Proposed Rule: Form 8-K Disclosure of Certain Management Transactions; Release Nos. 33-8090; 34-45742; (<http://www.sec.gov/rules/proposed/33-8090.htm>).

<sup>6</sup> See Release Nos. 33-8106; 34-46084. The only exceptions to the proposed two business day deadline relate to Form 8-K reports of insider transactions and are set forth in Release Nos. 33-8090; 34-45742.

2. No officer, employee or agent of the company knew, or was reckless in not knowing, that a report on Form 8-K was required to be filed and once an executive officer of the company became aware of its failure to file a required Form 8-K, the company promptly (and not later than two business days after becoming aware of its failure to file) filed a Form 8-K with the SEC containing the required information and stating the date, or approximate date, on which the report should have been filed.

Although the proposed safe harbor would shield a company from liability under Sections 13 and 15(d) for a late filing, that filing would not be considered timely. However, the SEC has also proposed amendments to Rule 12b-25 that would provide relief with regard to the timeliness of filings and short form eligibility.<sup>7</sup> Under the proposed rule, a company would have to file the Form 12b-25 one business day after the Form 8-K is due and file the Form 8-K within two business days after the original due date. If a company provides proper notice on Form 12b-25 and files a Form 8-K within the extended period permitted by Rule 12b-25, a company will not lose its eligibility to use short form registration statements as a result of its inability to timely file a Form 8-K.

## **Practical Implications of the Proposed Changes to Form 8-K**

- Companies should consider the adoption and implementation of procedures and systems to assure close monitoring of items and events to be reported on Form 8-K and the timely preparation and filing of such current reports, particularly with respect to the reporting of insider transactions. These procedures and systems may overlap with those adopted in connection with the proposed certification requirements discussed above, but companies should carefully assess whether internal procedures and systems also monitor insider transactions and each of the events or items that may require reporting on Form 8-K. Under the current SEC proposals, companies must implement such procedures in order to comply with requirements of safe harbor described above and the reporting of insider transactions.
- Many of the new Form 8-K disclosure items cover events and information that may currently be announced by public companies through a press release. The inclusion of such items as reportable events, however, would require companies to describe these events in more detail than would otherwise be included in a press release, as several of the proposed disclosure items require the filing of relevant agreements or documents in addition to the announcement of an event.
- Companies should consider the potential impact that the new Form 8-K disclosure items may have on the conduct of business in addition to their impact on reporting obligations. For example, the obligation to report a company's entry into a material agreement not made in the ordinary course of business, including letters of intent and other non-binding agreements, would have a significant impact on the conduct of merger and acquisition negotiations.

---

<sup>7</sup> See Release Nos. 33-8106; 34-46084.



---

# ARNOLD & PORTER

---

- A significant shortening of deadlines would result in an increase in the likelihood that companies may fail to file a Form 8-K in a timely manner. Absent the relief described above under proposed amendments to Rule 12b-25, a company that fails to file a Form 8-K in a timely manner would not be eligible to use short form registration statements. In addition, a company could not use Form S-8 and its security holders could not rely on Rule 144 unless it is current in its Exchange Act filings, including Form 8-K.
- The proposed reporting of insider transactions on Form 8-K is not intended to replace Section 16(a) reports that are currently filed by directors, executive officers and principal security holders. While the SEC is continuing to consider the appropriate relationship between filings on Form 8-K and Section 16(a) reports, companies should consider their current procedures with respect to Section 16(a) reporting and the feasibility of expanding those procedures to cover the proposed reporting of insider transactions on Form 8-K.

## SUMMARY

While the rules described above remain subject to comment and final adoption, the proposals have short comment periods and the SEC has expressed its intention to adopt final rules promptly after the expiration of the comment periods. Compliance with the new rules, particularly the rules relating to accelerated filing deadlines for periodic and current reports, the adoption and implementation of systems and procedures to assure compliance with the proposed rules, and new Form 8-K reporting obligations, will require significant advance planning and coordination. Arnold & Porter has assisted many public companies with the design and implementation of policies and procedures to help with accurate and timely public reporting. We also can help with the preparation and review of public reports. We would be pleased to consult on these matters.

\* \* \* \* \*

This is an overview of the proposed rules and not a substitute for a full analysis of the application of these proposed rules to particular situations. If you would like to receive more detailed information concerning these proposed rules or have any other questions, please feel free to call your Arnold & Porter attorney. Questions may also be directed to Richard E. Baltz at 202.942.5124 ([Richard.Baltz@aporter.com](mailto:Richard.Baltz@aporter.com)) or Virginia Liao at 202.942.5585 ([Virginia.Liao@aporter.com](mailto:Virginia.Liao@aporter.com)).



## **APPENDIX**

### **I. SEC Financial Reporting Releases**

- Cautionary Advice Regarding the Use of “Pro Forma” Financial Information in Earnings Releases; Release Nos. 33-8039, 34-45124, FR-59; (<http://www.sec.gov/rules/other/33-8039.htm>)
- Cautionary Advice Regarding Disclosure About Critical Accounting Policies; Release Nos. 33-8040; 34-45149; FR-60; (<http://www.sec.gov/rules/other/33-8040.htm>)
- Commission Statement about Management’s Discussion and Analysis of Financial Condition and Results of Operations; Release Nos. 33-8056; 34-45321; FR-61; (<http://www.sec.gov/rules/other/33-8056.htm>)

### **II. SEC Proposed Rules Relating to Reporting Obligations**

- Proposed Rule: Acceleration of Periodic Report Filing Dates and Disclosure Concerning Website Access to Reports; 17 CFR PARTS 229, 240 and 249; Release Nos. 33-8089; 34-45741; File No. S7-08-02; (<http://www.sec.gov/rules/proposed/33-8089.htm>)
- Proposed Rule: Form 8-K Disclosure of Certain Management Transactions; 17 CFR PARTS 230, 239 and 249; Release No. 33-8090; 34-45742; File No. S7-09-02; (<http://www.sec.gov/rules/proposed/33-8090.htm>)
- Proposed Rule: Disclosure in Management's Discussion and Analysis about the Application of Critical Accounting Policies; 17 CFR Parts 228, 229 and 249; Release Nos. 33-8098; 34-45907; International Series Release No. 1258; File No. S7-16-02; (<http://www.sec.gov/rules/proposed/33-8098.htm>)
- Proposed Rule: Certification of Disclosure in Companies' Quarterly and Annual Reports; 17 CFR PARTS 232, 240 and 249; Release No. 34-46079; File No. S7-21-02; (<http://www.sec.gov/rules/proposed/34-46079.htm>)
- Proposed Rule: Additional Form 8-K Disclosure Requirements and Acceleration of Filing Date; 17 CFR PARTS 228, 229, 240 and 249; Release Nos. 33-8106; 34-46084; File No. S7-22-02; (<http://www.sec.gov/rules/proposed/33-8106.htm>)