SEC: Notification Of Late Quarterly, Annual Filing Demands Full Disclosure

By Susan Schott Karr

On Feb. 14, the Securities and Exchange Commission sent a message to public companies on the need for full disclosure when filing a "Notification of Late Filing" form. The SEC brought a case against Forth Worth, Texas-based FFP Marketing Company, its former CFO, and its former controller, for poor disclosure related to the filing of the form (known as Form 12b-25).

"Any kind of public statement that is false and misleading is of interest to the [SEC] staff," said Alan Buie, SEC Enforcement assistant district administrator. "It's a staff position that this is a disclosure document."

For companies that are late in filing an annual or quarterly report, it is standard practice to fill out the SEC's Notification of Late Filing form. According to Buie, who handled the case, that in and of itself was not unusual. "The issue here is not that the filings were not made on time nor that financials needed to be restated," said Buie. "In so far as the form does require disclosure, if the form is inaccurate, this may be the basis for an SEC fraud or reporting charge."

"The SEC's message to executives is that the form does require some disclosure," added Buie.

What Happened

In June 2002, due to an overstatement of net income, FFP announced it would restate its financial results for 1999, 2000, and the first three quarters of 2001; FFP apparently was plagued bookkeeping errors, poor documentation of policies and procedures, and inadequate supervision within its accounting department. At the time, Craig Scott served as chief financial officer and general counsel of FFP, and Warner Williams was the company's controller.

It was not until FFP's outside auditors began preparation for their audit of FFP's December 2001 financial statements that the bookkeeping discrepancies began to surface.

When Williams realized FFP would not have audited financial statements in time to meet its Form 10-K filing deadline of April 1, Scott prepared, signed and filed the April Form 12b-25. The form required Scott to state "in reasonable detail the reasons why" the company was unable to file its Form 10-K. In filing such a report, the implication was that the report was "true and correct."

Although Scott had disclosed that the audit of the company's 2001 financial statements was not complete, he did not disclose that there was an ongoing inquiry into the company's overstated credit card receivables balance. In addition, he failed to disclose a $1.9 million write-down recorded by CFO Williams.

The SEC determined that Scott, in filing the forms, had "omitted to state material facts that were necessary to make statements in the April Form 12b-25 not misleading." According to the SEC, since FFP "failed to devise and maintain sufficient controls to prevent or detect the accounting irregularities that led to FFP's financial restatements," the company violated the Exchange Act. And when Williams failed to implement internal controls over FFP's accounting department, he was deemed the cause of the company's violations.

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- Ernest Ten Eyck, Former Assistant Chief Accountant, SEC

When FFP failed to file its 2001 Form 10-K by the April 15, 2002, extended deadline, AMEX suspended trading in FFP's stock. FFP then missed the filing deadline for its next Form 10-Q, and Scott filed another Form 12b-25 in May 2002. After the outside auditors completed their audit of FFP's financial statements and agreed with the final amount of the restatement, FFP filed its Form 10-K for 2001 and the Form 10-Q for first quarter 2002, announcing a restatement of net income for the period under question.

FFP, Williams and Scott have determined to settle, and the Commission has accepted their settlement. Scott, who was also charged with fraud, paid a $25,000 fine and did not admit nor deny the SEC allegations.

A Place Holder

The question regarding the FFP action is whether the incident was an isolated enforcement move related to more aggregious accounting errors, or whether public companies can expect more scrutiny over the late-filing forms. In other words, who cares about tiny FFP's error?

"The SEC cares," says Ernest Ten Eyck, a former assistant chief accountant at the Commission. "They care because 12b-25 is a disclosure document, as far as they're concerned, which means they're concerned what shareholders and others are reading in the public domain." According to Ten Eyck, the 10b-25 forms are disseminated as other SEC filings. "You can find it in EDGAR, just as you'd find the 10-K documentation."

And, as the Commission has noted on several recent occasions, and has been emphasized by several provisions of The Sarbanes-Oxley Act of 2002, disclosure must be thorough and complete. "You can't say something incomplete that may be misleading," adds Ten Eyck.

However, the late filing form hasn't been the subject of many SEC actions. In fact, many companies don't even consider the form an official filing. One widely held belief that the SEC's Buie has heard from public companies is that "It's not really a disclosure filing, but a 'place holder' [indicating] that you're going to be late in filing at public companies."

"It wasn't the case of the century," admits Buie. "It illustrated a point that is perhaps not novel, but a little bit unusual."

"It's a silly violation," adds Ten Eyck,

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representations—in essence creating an affirmative duty to enhance such disclosures simply based on the inclusion of a boilerplate representation in the merger agreement."

Wasserman noted that, in Titan's case, the FCPA matters were the subject of public disclosures after the filing of the merger agreement with the SEC. The Commission seems to suggest that a violation could occur even when a merger agreement representation as modified by an issuer's own pre-existing public statements is fully accurate, Wasserman said. This could "unfairly bootstrap a breach of a merger agreement representation into a potential SEC disclosure violation, apart from any separate violation, when nowhere in the context of a merger proxy are investors being told to rely on the merger agreement representations as direct representations made to them."

Although disagreeing with the SEC's reasoning, Wasserman said he would recommend that parties reconsider their practices concerning merger agreement representations. However, he said he does not believe the Titan report requires a significant change in practice in the case of merger proxies, and would not recommend publicly filing the confidential disclosure schedules that typically accompany an executed merger agreement.

"In some instances, however, it may be beneficial to simply refrain from reproducing the merger agreement representations in the merger proxy, since the representations themselves absent the associated disclosure schedule information do not provide very meaningful information to investors. Notably, there is no express legal requirement to attach the complete merger agreement as an annex to the merger proxy, though it has become common practice to do so."

But failure to attach a merger agreement may not solve the problem. "It is worth noting that the SEC report suggests that an issue can exist even when the merger agreement is merely incorporated by reference," Wasserman said.

Alternatively, notes Wasserman, companies should consider adding additional explanatory and disclaimer language when referencing the merger agreement representations. ▪

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given that it merely buys a company a few weeks. "They did their shareholders a big disfavor since they would have to file anyway. They were concealing something that, even it was hidden, wouldn't stay hidden for long."

Ten Eyck adds that the infraction was relatively minor. "At least there isn't a fraud charge against the company," he says. "Under SOX, they were probably scrambling to fix all of their problems; otherwise they wouldn't have been able to sign all of their certificates."

The Upshot

The key takeaway from the FFP case is that companies need to treat the extension form seriously. "You can treat 12b-25 as a disclosure document," says Ten Eyck. "It's not like filling out an extension of your tax forms. It must be the truth, the whole truth, and nothing but the truth."

Buie recommends candor in a situation where companies are conducting an internal investigation and the internal investigation is not complete at the time of a filing. Companies sometimes make public the idea that there is an investigation and that they will do what it takes to cooperate.

Ten Eyck says people who deal with outside professionals probably get good advice to make sure all relevant information is included. "You have to treat it like it's a 10-K," he says. "Make sure everything is in there."

To wit, FFP is not the only case regarding a notification of late filing. "There are other cases," says Buie at the SEC, though most of the cases dealt with "failure to file the form on time or at all."

In May 2004, the Commission charged The Warnaco Group with making a false and misleading statement, where "the misleading statements didn't relate to the numbers themselves but to the reasons for the numbers."

In a case against Gateway Medical Systems and its CEO, James Cheek, the SEC accused the parties of issuing materially false and misleading statements, and of committing fraud. "They too had filed a Notification of Late Filing in which they projected anticipated net income and profits that were grossly overstated and with no basis in fact," states Buie. "The Cheek case from 1989 is the only case I found in which the Commission charged a violation of Rule 12b-25 on the grounds that the Form 12b-25 was false."

Buie would not comment on whether the SEC planning on charging other companies. In any case, the charge against FFP, Williams and Scott may prove to be a reminder that the SEC is looking for full and fair disclosure in all documents in the public domain.

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or finance department committed fraud?

"It's a thorny issue," concedes David Katz, partner for Wachtell, Lipton, Rosen & Katz. "You can't look the other way and say, 'I didn't know.'"

For details and related coverage, go to www.complianceweek.com and enter **Print Reference Code: 050522**.

Judge Denies AFSCME Bid To Nominate AIG Directors

The American Federation of State, County and Municipal Employees has once again struck out in its bid to nominate directors to company boards.

In mid-March, a Federal judge refused to require the American International Group to include in its proxy statement a new bylaw that would allow certain shareholders to nominate directors at its upcoming annual meeting. The complaint, filed by AFSCME, sought to require AIG to include the pension plan's binding proxy access shareholder proposal on its proxy materials and bring the matter to a vote of shareholders at the company's annual meeting in May.

At the heart of the issue is SEC Rule 14a-8(i)(8), which governs shareholder proposals and requires corporations to include proposals from shareholders on their proxies.

In his relatively breezy, succinct seven-page ruling, Judge Louis Stanton of U.S. District Court Southern District of New York wrote that AFSCME's proposal "on its face relates to an election."

For details, including a copy of Judge Stanton's decision and extensive coverage of proxy access, go to www.compliance-week.com and enter **Print Reference Code: 050523**. ▪