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PERSPECTIVE

DR. T ON SECURITIES

Disclosure committees: A key component of good disclosure

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Disclosure committees in public companies are not a new phenomenon but recent cases and SEC enforcement actions have highlighted the need to revisit the structure and function of the disclosure committee and ensure best-in-class practices are implemented. Ensuring adherence to a solid framework and best practices helps to protect public companies and the members of their disclosure committees in the event of a lawsuit or enforcement action.

The recent *New England Carpenters* decision actually found in favor of the executive officers arguing that the certifications were non-actionable statements of opinion so long as the officer certifying believed what they had certified and had engaged in meaningful inquiry with respect to the disclosure in question. As such, the case solidified the critical importance and function of a disclosure committee in being able to provide protection for officers. This is because a disclosure committee's function and procedures allow officers to demonstrate that they did engage in meaningful inquiry and that the outcomes from such disclosure committee discourse supported their belief in a particular course of action as it relates to the company's disclosure. This is also critical in any SEC enforcement action.

The SEC has increasingly demonstrated that they are willing and prepared to sanction companies that fail to maintain proper disclosure controls and procedures. While the SEC will often include such a charge as a secondary component to a disclosure violation, recent enforcement actions have demonstrated that the SEC is also willing to attack companies and their executive officers based solely on a disclosure controls violation.

While not a guaranteed way to avoid lawsuits and SEC enforcement actions, disclosure committees that maintain strong governance have the best chance of thwarting any such claims or actions by providing a substantive basis for fighting against such attacks and providing CEOs and CFOs a strong foundation from which to provide their required certifications.

What is a disclosure committee?

Disclosure committees stemmed from Sections 302 and 906 of the Sarbanes-Oxley Act of 2002, which required that public company CEOs and CFOs include signed certifications in both their quarterly reports and their annual reports.

Section 302 certifications require CEOs and CFOs to certify that they are responsible for the accuracy of financial reports and their company's system of internal controls while Section 906 certifications require CEOs and CFOs to certify that the financial statements comply with SEC requirements and that the information contained within fairly present the financial condition of the company in all material respects.

To help CEOs and CFOs make such certifications, disclosure committees were born. The SEC does not mandate formation of such a committee but does mandate that companies maintain disclosure controls and procedures. Disclosure committees became the mechanism for implementing such controls and procedures and creating the types of checks and balances that are help-ful in supporting the certifications that CEOs and CFOs have to make.

Key governance elements for a good disclosure committee

The key governance elements for a good disclosure committee revolve around two key tenets: (a) discourse, (b) documentation, and (c) commitment to best practices.

For discourse to be effective, the disclosure committee needs to contain the right members. It is recommended that a strong functioning disclosure committee include (i) finance representatives, (ii) legal representatives, such as the general counsel, (iii) risk management officer, (iv) investor relations representative, and (v) representatives from one or more business units within the company. Given the SEC's recent focus on cybersecurity disclosure, it may also be helpful to have someone on the committee who is familiar with the company's technical and operational systems in order to advise on how to best ensure things that should be disclosed are rising to the right levels within the organization.

Documentation is multi-layered. It includes both documenting about the disclosure committee as well as documenting what actions the disclosure committee takes with respect to each company filing. Companies should establish a disclosure committee charter that outlines the roles and responsibilities of the committee. Such a charter should also spell out what disclosure will be reviewed by the committee, the membership of the committee, the frequency of meetings, and any relevant protocol for how the disclosure committee will function. Companies should also focus on documenting the ongoing actions of the committee. This would include establishing agendas for each meeting, taking meeting minutes, and following up meetings with questionnaires intended to confirm reviews have been undertaken and that all relevant items had been disclosed within the committee for discussion.

Finally, disclosure committee members should commit to best practices. This would include preparation, education, and quality improvement.

· Preparation: This would include such things as ensuring committee members receive draft disclosure in advance of meetings so that discourse during the meetings can be robust and decisions can be made and encouraging committee members to review the provided drafts and come to the meeting with thoughts and opinions on next steps;

· Education: This would include not only ensuring disclosure committee members remain current regarding disclosure trends and new SEC rules but also asking committee members to continue to educate other members of the organization regarding the importance of disclosure and helping all levels of the organization to know when to bring a disclosure item to the right level in the organization to ensure proper vetting;

· Quality Improvement: This would include an understanding and adherence to continuous improvement. Disclosure committees should consider having auditors and/or outside legal sit in on meetings to provide members with external perspectives. Another best practice is for disclosure committees to periodically undertake a formal evaluation process to ensure the policies and procedures used are best in class and that protocols can be updated as necessary to adjust to the changing needs of the organization and its disclosure regime.

Good disclosure results from planning and thought

While having a disclosure committee will not prevent lawsuits and SEC enforcement action, having a disclosure committee that follows good corporate governance and appropriately documents the discourse and decisions made will provide officers with a shield to help protect them in the event they are an unfortunate target. A good disclosure committee that is focused on a commitment to best practices will also help ensure that the company's public disclosure is adapting to the company's changing needs and providing comfort that the company's disclosure will remain on solid ground.

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