

PAUL, WEISS, RIFKIND, WHARTON & GARRISON

UPDATE ON SEC DISCLOSURE ISSUES

MARK S. BERGMAN

MAY 4, 2001



With increasing frequency, the Staff of the SEC's Division of Corporation Finance identifies issues of particular concern as well as areas of disclosure that the Staff believes merit reminders to public companies and their advisors. Set forth below is a summary of recent reminders and other items identified by the Staff as worthy of note:

Proxy Statements

- Registrants are reminded that they must disclose in their proxy statements whether their audit committee reviewed and discussed certain matters specified in Statement of Auditing Standards No. 61 (concerning the accounting methods used in the financial statements) and in Standard No. 1 of the Independence Standard Board (concerning matters that may affect the auditor's independence) with management and the auditors. They must also disclose whether the committee recommended to the Board that the audited financial statements be included in the Annual Report on Form 10-K.
- Registrants must disclose in their proxy statements whether their audit committee has a written charter, and must file a copy of their charter every three years.
- Under the recently promulgated rules governing independence of auditors, registrants must disclose in their annual proxy statements the fees for audit, information technology consulting and all other services provided by their auditors during the last fiscal year. Registrants must also state whether the audit committee has considered whether the provision of the non-audit services is compatible with maintaining the auditor's independence. Lastly, registrants are required to disclose the percentage hours worked on the audit engagement by persons other than the accountant's full-time employees, if that figure exceeds fifty percent.

Foreign Issuer Disclosures

- The Staff notes that, in reviewing filings by foreign issuers, they have seen some of the following:
- Errors in home-country GAAP financial statements disclosed only as items in the U.S. GAAP reconciliation, rather than corrected in the primary financial statements.
- Use of the cost method to account for subsidiaries and investees that are erroneously considered "immaterial."
- Failure to adjust an investee's local GAAP financial statements to the basis of accounting in the primary financial statements in applying the equity method.
- Excessive time lags between the financial statements of the investor and the investee in applying the equity method.

- Areas of SEC Focus in 2001
- The Staff has indicated that one significant focus of Staff reviews during 2001 will be to evaluate whether registrants have complied with:
 - the disclosure requirements of FASB Statement No. 131 (disclosures about segments of an enterprise and related information).
 - the disclosure requirements under SFAS 133, which establishes for the first time, a comprehensive accounting and reporting standard for derivative instruments and hedging activities. Registrants are reminded that the Staff expects (based on the requirements of S-X Article 10, which calls for interim period disclosure of significant changes in accounting principles and practices since year-end) that, when a new accounting standard is adopted in an interim period, all disclosures prescribed by the standard should be included in the relevant 10-Q.
 - the disclosure requirements in respect of derivatives and market risk (Item 305 of Regulation S-K).

Registrants are reminded to make specific reference in their 10-K or 20-F to Item 305 of Regulation S-K, which prescribes disclosure about derivatives and market risks inherent in derivatives and other financial instruments. Registrants can include the quantitative and qualitative disclosures under the Item reference, cross-reference from the Item referenced to the disclosures elsewhere in the filing or indicate under the Item referenced that the disclosures are not required. Registrants are also reminded to discuss material market exposures (to changes in interest rates, foreign currency movements, equity prices or commodity prices) even though they do not invest in derivatives. Registrants should consider risk factor disclosure of potential exposure to, or during, market shifts.

The market risk disclosures can refer to the financial statements but disclosures required by the rules should be furnished outside the financial statements. The forward-looking statements “safe harbor” provided in Item 305 does not extend to information presented in the financial statements.

- **Quarterly Reviews.** Registrants are not required to state in their Form 10-Q that the interim financial statements have been reviewed, and a report of the independent public accountants are not required in the filing unless the registrant states that the financial statements have been reviewed. If financial statements with which investors would associate the independent accountant are included in a Form 10-Q without the accountant’s timely review, the accountant is to request that the client promptly amend the filing to disclose that the financial statements are unaudited and have not been reviewed by an independent accountant as required by the 10-Q rules. If the client does not

take satisfactory action, the accountant must consider whether to resign or report directly to the SEC.

- **Correcting Financial Statements.** The Staff has raised issues with respect to corrections of errors or retroactive adjustment of accounting principles in financial statements that have previously been furnished with an accompanying audit report to securities holders or financial statements included in an SEC filing that are changed in subsequent amendments or other filings. In each case, disclosure must be made in the financial statements. For example, the Staff has noted that if financial statements used in a preliminary prospectus are subsequently changed for correction of an error, the Staff believes that financial statements and an audit report highlighting and explaining the restatement must appear in the final prospectus.

* * *

Mark S. Bergman is a partner in the New York office of Paul, Weiss, Rifkind, Wharton & Garrison.

©2001 Paul, Weiss, Rifkind, Wharton & Garrison.