
Corporate Advisor

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Getting Ready for New SEC Disclosure Requirements

On April 11, the Securities and Exchange Commission formally proposed its first wave of new disclosure “reforms”. Additional rule proposals are expected in the coming weeks and months. Usually, we do not publish *Corporate Advisors* describing rule proposals, since many proposals are never adopted or change significantly during the comment period. Given the current political pressure and public attention surrounding the issues addressed in these proposals, however, there is a high likelihood that some form of the proposals will quickly be adopted. In light of this, we thought it would be helpful to outline some preparatory actions public companies may now wish to begin considering.

Overview of Proposed New Rules

April 11 Proposal Relating to “Accelerated Filings”: The SEC proposed the following rule changes that would apply to a subset of reporting companies to be referred to as “accelerated filers”:

- Annual Reports on Form 10-K would be due 60 days after fiscal year end, rather than the current 90 days.
- Quarterly Reports on Form 10-Q would be due 30 days after the end of the quarter, rather than the current 45 days.
- Additional disclosure would be required concerning web site access to SEC reports. As part of this requirement, a company that does not post copies of its SEC reports to its own web site on the same day the report is filed would be required to disclose why it does not do so.

The SEC has proposed defining “accelerated filer” as a domestic reporting company that has:

- a public float of at least \$75 million;
- been subject to Exchange Act reporting requirements for at least 12 calendar months;
- and previously filed at least one annual report on Form 10-K.

A company would determine if it meets the public float test based on a date during the eleventh month of its fiscal year, with the testing date being selected by the company. Once a company becomes an accelerated filer, it would remain an accelerated filer, except in the unlikely event it later qualified as a small business issuer.

The SEC has proposed to make the new rules regarding accelerated filings effective beginning with fiscal years ending after October 31, 2002. For a calendar year company that meets the definition of an accelerated filer, that means next year’s 10-K would be its first accelerated filing.

April 11 Proposal Regarding 8-K Reporting of Management Transactions: The SEC has proposed new rules that would require all companies with a registered class of equity securities to file a Current Report on Form 8-K to report transactions by or involving executive officers and directors of the company. The following would need to be reported on the Form 8-K

- transactions in company equity securities, including (1) open market purchases and sales, (2) acquisitions, dispositions or exercises of options and other derivative securities, (3) transactions directly with the company and (4) gifts;
- entering into, modifying or terminating Rule 10b5-1 plans; and
- loans of money to a director or executive officer made or guaranteed by the company or an affiliate of the company.

The 8-K, which would be in addition to all existing requirements to file Form 144 and Section 16 reports, would be due:

- two business days after the transaction, in the case of a loan or transaction with a value of \$100,000 or more, other than a grant pursuant to an employee benefit plan;

and

- on the second business day of the week following the transaction, loan or other reportable event in most other cases.

Coming Attractions: During the next couple of months, the SEC anticipates formally proposing rules that will add the following additional disclosure requirements:

- Mandatory MD&A disclosure of critical accounting policies (which may be renamed “critical accounting judgments and estimates” in order to better capture the spirit of the disclosure the SEC is seeking).
- Mandatory 8-K reporting of several specified events, possibly including: (1) changes in credit ratings; (2) defaults and other events that could trigger acceleration of direct or contingent obligations; (3) transactions that result in material direct or contingent obligations; (4) private placements of securities; (5) waivers of corporate ethics and conduct rules; (6) material modifications to rights of security holders; (7) departure of the company’s CEO, CFO, COO or president; (8) new material agreements; (9) loss or gain of a material customer; and (10) any material write-offs, restructurings or impairments.

Getting Ready for the New Disclosure Regime

In order to smooth transition to the new reporting requirements, companies may find it helpful to begin now to reexamine their existing disclosure-related practices. Specifically, we recommend that you:

- **Evaluate your financial reporting systems and processes** to identify any improvements needed to enable the company to more quickly report accurate financial results. Even companies that will not immediately confront the shortened 10-K and 10-Q deadlines are likely to come under increasing pressure from investors and analysts to provide more real-time financial information, particularly if many of their direct competitors are accelerated filers. Of course, at the same time the SEC is seeking to require companies to “do it faster,” the need to “do it better” in terms of improving the quality of disclosure is also increasing. Many companies may not be able to achieve these twin directives without increasing the resources dedicated to financial reporting.
- **Revise schedules to minimize conflicting demands on your financial reporting group** during the shortened period of time the company will have to prepare SEC

reports. For example, some companies may want to modify the timing of offering periods under their employee stock purchase plans to avoid having an offering period expire shortly after the end of a fiscal period. Companies may also want to modify their traditional schedules for hosting analyst days or conducting off-site strategy sessions. Since many of these events are scheduled far in advance, it may be necessary to start to make adjustments even before final rules are adopted.

- **Discuss with your independent public accountants** whether some audit procedures can cost-effectively be conducted over the course of the year rather than only after year end. In addition, some companies may wish to consider changing their fiscal year end away from December 31, which is by far the busiest time for accounting firms.

- **Revise your processes for insiders to notify the company about stock transactions.** Most companies currently require officers and directors to provide prior notice of proposed transactions as part of the company's insider trading program. However, most companies do not follow up to determine whether transactions actually took place until after month end, which is timely for purposes of filing Section 16 reports, but will not be timely for purposes of meeting the new 8-K requirements. In addition, as proposed, the new 8-K reporting requirements would pick up transactions, such as option grants, dispositions to the issuer and gifts, that companies currently do not need to focus on until the year-end Form 5 filing. The SEC has said that implementation of procedures sufficient to provide reasonable assurance that the enhanced 8-K reporting requirements are met, and of a system for applying such procedures, will be a prerequisite for companies to avoid sanctions for any reporting violations that may occur.

- **Catalog all existing 10b5-1 plans.** When the new 8-K rule regarding reporting of Rule 10b5-1 plans is adopted, it is likely that there will be an initial obligation to disclose all ongoing plans originally entered into prior to the effective date of the new rule. Companies should collect and review all existing plans now so that any issues can be identified and addressed. In particular, insiders will want to assess whether any changes should be made to existing plans in light of the new disclosure requirements that are proposed to apply when a 10b5-1 plan is modified or terminated. Under the SEC's proposal, if a 10b5-1 plan is modified, the company must provide a description of the modification, including any change to the plan's duration, the aggregate number of securities involved, the interval at which securities are to be purchased or sold, the number of securities to be purchased or sold in each interval and the price at which securities are to be purchased or sold. This disclosure could

be provided in general terms, without disclosing the specific price, number of securities or duration of interval.

- **Develop internal processes for alerting the officers and counsel who oversee 8-K filings of when a reportable event has occurred.** The current 8-K reporting requirements are fairly limited and represent events that are generally hard to miss (change in control, material acquisition or disposition, bankruptcy, change in accountants, resignation of director due to a disagreement, change in fiscal year). As indicated above, the universe of events reportable on 8-K is likely to grow significantly. In addition, many of the new 8-K items will require greater judgment to determine whether or not a reportable event has occurred.
- **Reevaluate in-house EDGAR capabilities.** The new rules are going to require a greatly increased number of 8-K filings and these filings will need to be made much more quickly than in the past. Companies may be able to save a considerable amount of money by handling these filings in-house, rather than relying on an outside service provider. At the same time, the shortened filing deadlines may make it more efficient to use an outside filing service for the 10-K and 10-Q, particularly when numerous exhibits must be filed. Companies that complete some or all of their filings in-house should train more than one person to make filings, since it will be much harder to schedule around vacations and other absences.
- **Review how you manage the company's web site.** In particular, the company's existing arrangements for making SEC filings available on its web site should be reviewed in order to make sure they provide for dissemination as soon as reasonably practicable on the date the filing is made with the SEC. For example, merely providing a link to the official SEC web site, www.sec.gov, will not be sufficient since the SEC's web site posts filings on a one business day delay. Keep in mind, however, that one of the most common (and embarrassing) web site mistakes is the posting of a document version that is not quite identical to the version as filed.
- **Consider directly voicing your concerns about the new rule proposals** by sending a comment letter to the SEC. The rule proposals each include numerous questions that the SEC staff is seeking input on from affected parties. Comments can be submitted by letter or e-mail. The comment period is until May 23, 2002 for the accelerated filing proposals and until June 24, 2002 for the new 8-K reporting requirements.

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