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ANNUAL REPORTING COMPANY UPDATE

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This Memorandum is offered as a reminder of developments since last year at about this time affecting the preparation of annual reports to shareholders, proxy statements for shareholder meetings, and annual reports to the Securities and Exchange Commission pursuant to the Securities Exchange Act of 1934.

Many readers will be aware of the surge in SEC rule-making activity to meet mandates contained in the Sarbanes-Oxley Act of 2002, especially the flurry of releases in the last three weeks. However, many of the new requirements will not take effect or full effect until after calendar-year-end companies have completed their 2002 annual reports and 2003 annual meetings.

The first part of this Memorandum emphasizes new requirements that need to be taken into account for the current reporting/proxy season. There follow descriptions of new requirements that, while not requiring immediate attention, need to be earmarked for early evaluation and planning.

The Securities Practice Group has produced a number of memoranda relating to the Sarbanes-Oxley Act and the new SEC rules. If you would like copies or other information or assistance, please contact any member of the Securities Practice Group, whose names and e-mail and telephone addresses appear at the end of this Memorandum.

I. REQUIREMENTS AFFECTING THE CURRENT REPORTING AND PROXY SEASON

1. Reports on Form 10-K and 10-KSB and Proxy Statements -- Disclosure of Equity Compensation Plan Information

As described in last year's edition of this Memorandum, in December 2001, the SEC amended Regulation S-K, Regulation S-B, Regulation 14A, Form 10-K and Form 10-KSB to require increased disclosure concerning equity compensation plans (Release No. 33-8048 (December 19, 2001)). The changes were effective for Forms 10-K and 10-KSB filed for years ending after March 14, 2002 and to proxy statements for meetings of shareholders occurring after June 14, 2002. Thus, they now apply to virtually all registrants.

In essence, the new rules will require additional disclosures (i) in Forms 10-K and 10-KSB every year and (ii) in proxy statements in years when equity compensation plans are submitted for shareholder approval.

The highpoints:

- The most visible change in filings will be a table of data about equity compensation plans in the following prescribed form:

Equity Compensation Plan Information

	(a)	(b)	(c)
Plan Category	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a))
Equity compensation plans approved by security holders			
Equity compensation plans not approved by security holders			
Total			

The table thus brings together in one place aggregate data for shares presently committed under all equity comp plans, including pricing, as well as for shares still available to be issued under plans. It also responds to concerns that investors don't receive adequate information about "equity transfers" to management under arrangements not submitted to them for approval.

- This disclosure is *not* required in Annual Reports to Shareholders.

- The table is to capture data for all equity comp "plans," including arrangements for single individuals or a small group.

- The requirements do not apply to employee benefit plans that are intended to be qualified under Section 401(a) of the Internal Revenue Code.

- Plans for non-management as well as management employees and directors must be included in the aggregate data.

- In addition to the tabular disclosure, the new rules require brief narrative descriptions of all equity comp plans adopted *without* shareholder approval. However, some registrants may decide to describe all plans, to give a more balanced presentation.

- The new rules amend Item 201 of Regulations S-K and S-B, Market Price of and Dividends on the Registrants Common Equity and Related Stockholder Matters, and so registrants may well choose to place the disclosure following their dividend and stock price table(s).

- To meet the narrative disclosure requirements, registrants may make cross-references to disclosures in the notes to financial statements pursuant to SFAS 123, Accounting for Stock-Based Compensation. However, the SFAS disclosures may not meet the Item 201 requirements and the SEC staff has indicated that it disfavors "split" disclosure.

- Finally, Item 601(b)(10) of Regulation S-K has been amended to require filing of all plans, including existing plans, adopted without shareholder approval, not (as previously) just plans for "named executive officers" or other management, excluding plans that are immaterial in amount

or significance. The immateriality exception does not apply to plans in which a director or officer participates.

Release No. 33-8048 (December 19, 2001) may found at **www.sec.gov/rules/final/33-8048.htm**.

2. **Proxy Statements -- Disclosure Concerning Late Filings of Form 4**

Item 7 of Regulation 14a requires that, if directors are to be elected at a shareholders' meeting, the proxy statement for the meeting must contain, among other things, the information required by Item 405 of Regulation S-K. The latter requires disclosure of failures to file or late filings of reports required by Section 16(a) of the '34 Act (Forms 3, 4 and 5) by directors, officers, 10% beneficial owners or other reporting persons.

In Release No. 34-46421 (August 27, 2002), the SEC, in conformity with Section 403 of the Sarbanes Oxley Act, amended certain of the rules and Forms adopted pursuant to Section 16(a) of the '34 Act, primarily to require accelerated filing of Form 4's and to move the reporting of some transactions from Form 5 to Form 4. Release No. 34-46421 may found at **www.sec.gov/rules/final/34-46421.htm**.

These changes were effective August 29, 2002. Accordingly, determining compliance with Section 16(a) will involve two somewhat different standards, one for the period before and the other for the period on or after that date. This circumstance might well require revision of D&O questionnaire this year and a further revision next year.

3. **Reports on Form 10-K and Form 10-KSB -- Certifications Required by Sections 302 and 906 of the Sarbanes Oxley Act**

By now, all registrants have some experience with these certifications and have established their compliance procedures. The SEC issued its answers to a number of frequently asked questions concerning the Sarbanes-Oxley Act, many of which relate to Section 302 certifications. See **www.sec.gov/divisions/corpfin/faqs/soxactr2002.htm.**

4. **Annual Reports to Shareholders, Proxy Statements and Other Non-Filed Disclosures -- Use of Non-GAAP Financial Measures**

In Release No. 33-8176 (January 22, 2003), the SEC adopted new rules governing the public disclosure or release by reporting companies (other than registered investment companies) of financial information that is calculated and presented on the basis of methodologies other than generally accepted accounting principles. See **www.sec.gov/rules/final/33-8176.htm**.

The highlights:

- The new rules apply to non-GAAP financial measures in information disclosed or released after March 28, 2003 except such measures contained in Form 10-Ks and 10-Qs for periods ended *on or prior to* March 28, 2003. Thus, non-GAAP measures contained in annual reports to shareholders, proxy statements or earnings releases issued after March 28, 2003 will be subject to the new rules as will Form 10-Qs for the quarter ended March 31, 2003.

- The new rules consist of two main elements:

  - a new Regulation G, generally applicable to all use of non-GAAP financial measures, and

  - additions to Item 10 of Regulation S-K (and Regulation S-B), generally providing additional requirements with respect to use of such measures in filings with the SEC.

- Generally, a non-GAAP financial measure is a numerical measure of a registrant's historical or future financial performance, financial position or cash flows that:

  - excludes, actually or effectively, amounts included in the most directly comparable GAAP measure, or

- includes, actually or effectively, amounts excluded in the most directly comparable GAAP measure.

The adopting release offers and discusses several examples of measures that are or are not non-GAAP financial measures, in the SEC's estimation.

- Regulation G:
  - contains a general prohibition against making public a non-GAAP financial measure that, taken together with accompanying information, contains an untrue statement of material fact or omits to state a material fact necessary to make the presentation of the measure, in light of the circumstances under which it is presented, not misleading, and
  - requires the registrant to provide
    - a presentation of the most directly comparable GAAP financial measure, and
    - a reconciliation of the differences between the non-GAAP and most directly comparable GAAP measures.
- the addition to Item 10 of Regulation S-K (and Regulation S-B), which applies to reports filed with the SEC, requires disclosures in addition to those prescribed by Regulation G and prohibits several specific practices in connection with the inclusion of non-GAAP financial measures in such reports.

Clearly, reporting companies will wish to review their annual reports, proxy statements and releases to be published after March 28, 2003 to detect any non-GAAP financial measures and comply as necessary with Regulation G. Then, their first Form 10-Qs for a period ending after March 28 will be subject both to Regulation G and Item 10 of regulations S-K and S-B.

5. Earnings Releases -- New Item 12 of Form 8-K "Disclosure of Results of Operations and Financial Condition"

Also in Release No. 33-8176 (January 22, 2003), the SEC amended Form 8-K to require registrants to "furnish" a report on that form within five business days after a public announcement or release disclosing material non-public information regarding results of operation or financial position for an annual or quarterly period just ended. In Item 12 of Form 8-K, registrants would identify the announcement or release, which would be a required exhibit to the Form 8-K. As noted, the Form 8-K is to be "furnished," not "filed," a distinction that is significant on several counts relating to liability, as explained in the adopting release.

6. Reports on Form 10-K -- Disclosure Concerning Website Access to Reports Required of Class of "Accelerated Filers"

In Release No. 33-8128 (September 5, 2002), the SEC adopted accelerated filing requirements for annual and quarterly reports by a defined class of issuers called "accelerated filers." These requirements phase in over a three-year period, beginning with the fiscal year ending on or after December 15, 2003 for annual reports.

The same Release, however, requires accelerated filers to make additional Form 10-K disclosures regarding website access to their '34 Act reports with respect to years ending on or after December 15, 2002. Hence they will apply this year to calendar year accelerated filers.

- As defined in amended Rule 12b-2, a registrant is an "accelerated filer" when:
  - the aggregate market value of its voting and non-voting common equity held by non-affiliates is $75 million or more,
  - it has been subject to reporting requirements under the '34 Act for at least 12 months and has filed at least one Form 10-K or Form 10-KSB, and

- it is not (or no longer) eligible to use Form 10-KSB or Form 10-QSB for its reporting.

- The new requirements are found in Item 101(e) of Regulation S-K and require the registrant to state:

  - its Internet address, if it has one, and

  - whether it will make available on or through its website, if any, its annual, quarterly and current (Form 8-K) reports and amendments as soon as reasonably practicable after it files them with or furnishes them to the SEC.

Release No. 33-8128 (September 5, 2002) may found at **www.sec.gov/rules/final/33-8128.htm**.

II. NEW REQUIREMENTS AFFECTING FUTURE REPORTS AND PROXY SEASONS

These additional requirements are described in the following in a cursory way, with an indication of how and when they will affect registrants.

7. Auditors Retention of Records Relevant to Audits and Reviews

On January 24, 2003, the SEC added a new Section 2.06 to Regulation S-X to require auditors to retain certain records relevant to each of their audits and reviews of financial statements of reporting companies and registered investment companies for a period of seven years from completion of the audit or review. (Release No. 33-8180 (January 24, 2003), which may be found at **www.sec.gov/rules/final/33-8180.htm**.

Highlights for issuers:

- The rule is effective with respect to audits and reviews completed on or after October 31, 2003.

- The rule does not impose any record retention requirements on issuers *per se*. It also does not require auditors to retain copies of all issuer's records that they examine but do not copy for other purposes. Nevertheless, one wonders if auditors themselves may not either [i] request or require issuers to maintain such records for the same seven year period or [ii] decide to copy far more issuer records than has been their practice heretofore.

- The SEC was generally unsympathetic to suggestions that compliance costs would be higher than suggested in the proposing or adopting releases. Certainly, one can expect such costs to affect audit and review fees.

- Another obvious potential consequence of the rule is to make records accessible to discovery in legal proceedings for longer periods than may presently be the case.

8. Insider Trading During Pension Fund Blackout Periods

These prohibitions on trading by directors and executive officers, incorporated into new Regulation BTR, became effective January 26, 2003 (except as to requirements for notice to the SEC, which will be effective beginning March 31, 2003). It should not be necessary for registrants to take them into account specifically in relation to their annual reports to shareholders, proxy statements and annual reports to the SEC. The prohibitions were adopted Release No. 34-47225 (January 22, 2003), which may be found at **www.sec.gov/rules/final/34-47225.htm**.

9. Reports on Form 10-K and 10-KSB -- Disclosure Regarding Code of Ethics Applicable to CEO, CFO, CAO, Controller or Others

On January 23, 2003, the SEC amended Item 10 of Form 10-K (and Item 9 of Form 10-KSB) to require disclosure of information required by new Item 406 of Regulation S-K (or Item 406 of Regulation 10-KSB) regarding codes of ethics for certain classes of managers. See Release No. 33-8177 (January 23, 2003), which may be found at **www.sec.gov/rules/final/33-8177.htm**.

Highlights of Item 406 of Regulation S-K include:

- the disclosure requirement is effective for fiscal years ending on or after July 15, 2003
- the essential disclosure required is whether the registrant has adopted a code of ethics and, if not, why not
- the code of ethics must cover the principal executive officer, principal financial officer. principal accounting officer or controller or persons performing similar functions
- a code of ethics must satisfy the SEC's definition of the term
- the registrant must file the code of ethics with the SEC, put it on its website or offer to provide copies upon request
- the registrant must disclose certain amendments to or waivers of the code of ethics under a new Item 10 of Form 8-K unless excused by the instructions to that Item

10. **Reports on Form 10-K and 10-KSB -- Disclosure Regarding "Audit Committee Financial Expert"**

Release No. 33-8177 (January 23, 2003) also amended Item 401 of Regulation S-K (and Regulation S-B) to add a new paragraph (e). Information responsive to Item 401 is required pursuant to Item 10 of Form 10-K (and Item 9 of Form 10-KSB).

Highlights of new paragraph (e) of Item 401 of Regulation S-K include:

- the disclosure requirement is effective for fiscal years ending on or after July 15, 2003 except that for small business issuers the date is December 15, 2003
- the essential disclosure required is whether or not the registrant has at least one "audit committee financial expert" serving on its audit committee and
- if not, why not, or
- if so, the name of the individual and whether he or she is "independent"
    - the term "audit committee financial expert" is defined by the rule in terms that leave a fair amount of room for interpretation and may prove to be the most difficult part of the rule to apply
    - to define "independent," the rule refers to the guidance in Item 7 of Regulation 14A

Registrants who do not already have an "audit committee financial expert" on board or standing by now have about a year to solve the problem. However, it is certainly possible that corporate governance requirements of the NYSE or NASDAQ will be adopted that will affect this time period.

11. **Proxy Statements -- Disclosure Regarding Auditor Fees**

On January 28, 2003, the SEC adopted a number of significant rule changes generally intended to enhance auditor independence, as announced in its 114-page Release No. 33-8183 (January 28, 2003), which may be found at **www.sec.gov/rules/final/33-8183.htm**.

- From an issuer's perspective, the most definite change is the revision to paragraph (e) of Item 9 of Regulation 14A, generally concerning fees paid to auditor, which
    - modifies the categories of disclosable fee amounts, and
    - extends the disclosure period from one to two years.

Although the release is not entirely clear, it appears the new disclosure will first apply to fiscal years ended after December 15, 2003.

- The more substantial impacts of the new rules relate to maintaining auditor independence from issuers, primarily through revisions to the independence standards in Regulation S-X to

  - revise and further define the types of non-audit services that are inconsistent with independence,

  - add standards for audit partner rotation,

  - restrict former auditor employments by issuers, and

  - provide for audit committees to administer the auditor's engagement on behalf of the issuer.

In general, the new requirements will only operate to prevent new arrangements entered into on or after 90 days from their publication in the Federal Register.

- Responding to another Sarbanes-Oxley Act mandate, the new rules also require auditors to report to audit committees concerning the issuer's critical accounting policies, alternatives treatments of material accounting issues that have been discussed with management and material written communications between the auditor and management. It appears that, as a practical matter, these requirements will first apply during the period preceding the filing of an issuer's Form 10-K or Form 10-KSB to be filed on or after 90 days from publication of the new rules in the Federal Register.

12. **Reports on Form 10-K -- Disclosure and Analysis about Off-Balance Sheet Arrangements and Aggregate Contractual Obligations**

On January 28, 2003, the SEC revised Item 303 of Regulation S-K, "Management's Discussion and Analysis of Financial Condition and Results of Operations," to create a new section devoted to disclosure regarding off-balance sheet arrangements and a tabular presentation of certain contractual obligations. The corresponding new section of Regulation S-B does not require the tabular presentation. See Release No. 33-8182 (January 28, 2003), which may be found at **www.sec.gov/rules/final/33-8182.htm**.

The highlights:

- The new disclosure requirements apply to reports and proxy statements containing financial statements for fiscal years ending on or after July 15, 2003 while the requirements relating to tabular disclosure will apply for fiscal years ending on or after December 15, 2003.

- A disclosable off-balance sheet arrangement is any of four defined types of transactions, agreements or other contractual arrangements between the registrant and an entity that is not consolidated with the registrant that has or is reasonably likely to have a current or future financial effect on the registrant of a defined type that is material to investors.

- Required disclosure includes, in broad summary, the nature and business purpose of the arrangement, its importance in financial terms, various financial characteristics and known factors that will or are reasonably likely to affect the registrant's benefits from the arrangement.

- The tabular disclosure required of registrants other than small business issuers must disclose aggregate amounts of specified obligations in the following form:

	Payments due by period				
Contractual Obligations	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
[Long-Term Debt Obligations]					
[Capital Lease Obligations]					
[Operating Lease Obligations]					
[Purchase Obligations]					
[Other Long-Term Liabilities Reflected on the Registrant's Balance Sheet under GAAP]					
Total					

- The tabular presentation is to be accompanied by footnotes to describe provisions that create, increase or accelerate obligations and other information needed to understand the timing and amount of the obligations.

13. **Implementation of Standards of Professional Conduct for Attorneys**

On January 29, 2003, the SEC adopted standards of professional conduct for attorneys that will likely affect registrants and their relationship with their inside and outside legal counsel as the latter try to adapt to the standards and that may lead to additional duties of audit committees or creation of new committees referred to in the Standards as "qualified legal compliance committees." See Release No. 33-8185 (January 29, 2003), which may be found at **www.sec.gov/rules/final/33-8185.htm**.

The Standards will not take effect until 180 days after their publication in the Federal Register and so should have no effect during the current reporting/meeting season.

In essence, the standards apply to attorneys representing issuers before the SEC in defined ways and generally require them to report evidence of material violations of securities laws or of fiduciary duties to specified management personnel and, if they do not respond appropriately, to the board of directors, the audit committee or a standing "qualified legal compliance committee."

The SEC has under consideration elaborations of these Standards, which in significant respects appear to be a work in progress and which we will be studying with particular care.

Again, if you would like copies of our explanatory memoranda or other information or assistance, please contact any member of the Securities Practice Group, listed below.

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