

GAAP-SEC Disclosure Requirements

Steering Committee Report Series

Business Reporting Research Project

Business Reporting Research Project

This Report is one of three published sections of a broad study—the Business Reporting Research Project—sponsored by the FASB to determine, in selected industries, the kind of business information corporations are reporting outside of financial statements. A 14-person Steering Committee consisting of members of the Board's constituencies supervised the project. (See the list of Steering Committee members on the inside back cover.)

In addition to eight industries studied, two separate studies complete the project. The first, in the pages that follow, identifies redundancies between GAAP and SEC disclosure requirements and ways to eliminate them as well as other observations that the SEC is encouraged to consider in future rule-making activities. The second describes the electronic distribution of business information and casts a new light on the exciting possibilities and problems of the Internet and technology on the business reporting universe.

The Steering Committee wishes to thank the members of the GAAP-SEC Disclosure Requirements Working Group, one of the seven working groups involved in the overall project, for their preparation of this Report.

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INTRODUCTION

Both generally accepted accounting principles (GAAP) and the Securities and Exchange Commission (SEC) rules contain many disclosure requirements. Disclosure requirements that are redundant are unnecessary and create confusion and wasted effort.

As part of the Business Reporting Research Project sponsored by the Financial Accounting Standards Board (FASB), the GAAP-SEC Disclosures Working Group was formed with the following objectives:

- To identify and suggest ways to eliminate redundancies between GAAP and SEC disclosure requirements
- To look at one of the SEC's specialized industry reporting requirements (Guide 3, Statistical Disclosure by Bank Holding Companies was selected) and provide suggestions on it
- To recommend improvements to the structure and organization of disclosures within Form 10-K
- To make other observations about SEC disclosure requirements that should be considered for revisions or elimination.

The Working Group consists of individuals from the FASB's constituencies with extensive experience with and interest in SEC and financial reporting. The process used by the Working Group to identify redundancies is discussed in Appendix A. This Report is a result of the Working Group's efforts.

Chapter 1 of this Report discusses redundancies found and suggests ways to eliminate them. Redundancies were found in the following areas:

- Income tax disclosures
- Disclosures about a major customer
- Disclosure of contingencies
- Disclosure of risks related to financial instruments
- Related party transactions
- Earnings per share computations
- Research and development expenses
- Segment information
- Disclosures of allowances for doubtful accounts.

Chapter 2 discusses a challenge and recommendation to prevent redundancies from occurring in the future.

Chapter 3 presents suggestions to improve the SEC's Industry Guide 3.

Chapter 4 presents recommendations to improve the structure and organization of disclosures within Form 10-K, and Appendix B presents an example of how such a rearranged Form 10-K would look.

Chapter 5 discusses observations about other SEC disclosure requirements that should be considered for revision or elimination.

CHAPTER 1— REDUNDANCIES FOUND

The GAAP-SEC Disclosures Working Group was asked to find situations where disclosure requirements in GAAP and the SEC's rules overlap and to suggest ways to eliminate the redundancies. The charge to the Working Group was *not* to identify disclosure requirements in either GAAP or the SEC's rules that they believe have outlived their usefulness or might otherwise be deemed not meaningful.

Appendix A describes the methodology and approach that the Working Group used to identify redundancies. Because of time constraints, the review was limited to accounting standards and SEC rules that were expected to yield the greatest number of redundancies, and additional redundancies undoubtedly exist in other areas.

Some may observe that GAAP and SEC rules have fewer redundancies than they expected. The expectation of finding more redundancies might be due to the fact that some registrants disclose similar (or identical) information multiple times in their Form 10-K in an effort to avail themselves of certain safe-harbor protections or to make the various parts of the Form 10-K read like a stand-alone document and not because of redundant GAAP and SEC requirements. Another reason for finding fewer redundancies than expected might be that many redundancies were eliminated as a result of the work done by similar groups in the late 1970s and early 1990s.

The Steering Committee for the Business Reporting Research Project has recommended that the Financial Accounting Standards Advisory Council (FASAC) be asked, in its advisory capacity, to monitor FASB and SEC progress in eliminating the redundancies identified in this report. That could be accomplished by requesting the FASB chairman and the SEC representative to discuss progress on this matter in their reports to FASAC periodically.

The redundancies identified and suggested actions to eliminate them follow.

Income Tax Disclosures. FASB Statement No. 109, *Accounting for Income Taxes*, and Regulation S-X Article 4-08, "General Notes to Financial Statements"

Nature of Redundancy

The disclosure requirement of Regulation S-X Article 4-08(h)(1) is redundant with paragraph 45 of Statement 109, because both require disclosure of the significant components of income tax expense for the period. Also, the disclosure requirements of Article 4-08(h)(2) and paragraph 47 of Statement 109, which require the presentation of a reconciliation of the statutory tax rate to the company's effective tax rate, are duplicative.

Working Group Recommendation

We recommend the following revisions to Article 4-08(h)(1) and (2) of Regulation S-X:

(1) <u>Disclose</u> <u>Disclosure shall be made in the income statement or a note thereto, of (i) the components of income (loss) before income tax expense (benefit) as either domestic or foreign; (ii) the components of income tax expense, including (A) taxes currently payable and (B) the net tax effects, as applicable, of timing differences (indicate separately the amount of the estimated tax effect of each of the various types of temporary timing differences, such as depreciation, warranty costs, etc., where the amount of each such tax effect exceeds five percent of the amount computed by multiplying the income before tax by the applicable statutory Federal income tax rate; other differences may be combined.)</u>

Note: Amounts applicable to United States Federal income taxes, to foreign income taxes and the other income taxes shall be stated separately for each major component. Amounts applicable to foreign income (loss) and amounts applicable to foreign or other income taxes which are less than five percent of the total of income before taxes or the component of tax expense, respectively, need not be separately disclosed. For purposes of this rule, foreign income (loss) is defined as income (loss) generated from a registrant's foreign operations, i.e., operations that are *located outside* of the registrant's home country.

(2) For purposes of providing the Provide a reconciliation between the amount of reported total income tax expense (benefit) and the amount computed by multiplying the income (loss) before tax by the applicable statutory Federal income tax rate, showing the estimated dollar amount of each of the underlying causes for the difference, each reconciling item in excess of five percent should be disclosed. If no individual reconciling item amounts to more than five percent of the amount computed by multiplying the income before tax by the applicable statutory Federal income tax rate, and the total difference to be reconciled is less than five percent of such computed amount, no reconciliation need be provided unless it would be significant in appraising the trend of earnings. Reconciling items that are individually less than five percent of the computed amount may be aggregated in the reconciliation. The reconciliation may be presented in percentages rather than in dollar amounts. Where the reporting person is a foreign entity, the income tax rate in that person's country of domicile should normally be used in making the above computation, but different rates should not be used for subsidiaries or other segments of a reporting entity. When

the rate used by a reporting person is other than the United States Federal corporate income tax rate, the rate used and the basis for using such rate shall be disclosed.

- (3) Paragraphs (h) (1) and (2) of this section shall be applied in the following manner to financial statements which reflect the adoption of Statement of Financial Accounting Standards 109, "Accounting for Income Taxes."
- (i) The disclosures required by paragraph (h) (1) (ii) and by the parenthetical instruction at the end of paragraph (h) (1) and by the introductory sentence of paragraph (h) (2) of this section shall not apply.
- (ii) The instructional note between paragraphs (h) (1) and (2) and the balance of the requirements of paragraphs (h) (1) and (2) of this section shall continue to apply.

Disclosures about a Major Customer. FASB Statement No. 131, *Disclosures about Segments of an Enterprise and Related Information*, and Regulation S-K Item 101(c)(vii), "Narrative Description of Business"

Nature of Redundancy

The disclosure about major customers required by Regulation S-K is largely redundant with the disclosure required by paragraph 39 of Statement 131. Paragraph 115 of Statement 131 exempts nonpublic companies from presenting this information and, as a result, this requirement only applies to companies that are already subject to Regulation S-K.

Working Group Recommendation

We recommend that this disclosure requirement be eliminated from Statement 131 in its entirety, as noted below:

39. An enterprise shall provide information about the extent of its reliance on its major customers. If revenues from transactions with a single external customer amount to 10 percent or more of an enterprise's revenues, the enterprise shall disclose that fact, the total amount of revenues from each such customer, and the identity of the segment or segments reporting the revenues. The enterprise need not disclose the identity of a major customer or the amount of revenues that each segment reports from the customer. For purposes of this Statement, a group of entities known to a reporting enterprise to be under common control shall be considered as a single customer,

and the federal government, a state government, a local government (for example, a county or municipality), or a foreign government each shall be considered as a single customer.

The elimination of this disclosure requirement from Statement 131 will have an impact on registrants who file financial information pursuant to the provisions of Regulation S-B. Regulation S-B does not contain a provision that requires the disclosure of significant customers. Because we believe that this disclosure is important to investors, we advocate the addition of the following disclosure requirement to Regulation S-B Item 101:

(13) The dependence of the segment upon a single customer or a few customers, the loss of any one or more of which would have a material adverse effect on the segment. The relationship, if any, with the customer and the registrant or any of its subsidiaries shall be disclosed if sales to the customer by one or more of the segments revenues are in an aggregate amount equal to 10 percent or more of the registrant's consolidated revenues and the loss of such customer would have a material adverse effect on the registrant and its subsidiaries taken as a whole. For purposes of this paragraph, a group of customers under common control or customers that are affiliates of each other shall be regarded as a single customer.

Disclosure of Contingencies. FASB Statement No. 5, *Accounting for Contingencies*, AICPA Statement of Position (SOP) 96-1, *Environmental Remediation Liabilities*, Regulation S-K Item 103, "Legal Proceedings," Item 103 of Regulation S-B, "Legal Proceedings," and Item 8.A.7 of Form 20-F, "Consolidated Statements and Other Financial Information."

Nature of Redundancy

Statement 5 provides the basic guidance in GAAP about the disclosure of loss contingencies. Those disclosure requirements are generally not prescriptive and allow for a significant amount of judgment about when to disclose a loss contingency. Thus, a disclosure decision is in large part based on the company's assessment of probability and its ability to reliably estimate the amount related to the contingency. When disclosure is deemed to be required, the information that is required to be disclosed is generally less detailed than that required by Regulation S-K.

We have the following observations about the detailed disclosures required by Item 103 of Regulation S-K, some of which apply to the captioned Regulation S-B and Form 20-F requirements: (a) certain of the basic provisions of the rule are redundant with the disclosure requirements of Statement 5 (for example, the requirement to disclose any ma-

terial pending legal proceedings) and (b) certain of the disclosure requirements, as they pertain to environmental liabilities, are redundant with SOP 96-1.

Working Group Recommendation

We recommend that Item 103 of Regulation S-K be modified as follows:

Item 103. Legal Proceedings.

Describe briefly any material pending legal proceedings, other than ordinary routine litigation incidental to the business, to which the registrant or any of its subsidiaries is a party or of which any of their property is the subject. In describing legal proceedings required under generally accepted accounting principles, include the name of the court or agency in which the proceedings are pending, the date instituted, the principal parties thereto, a description of the factual basis alleged to underlie the proceeding and the relief sought. Include similar information as to any such proceedings known to be contemplated by governmental authorities.

Instructions to Item 103.

- If the business ordinarily results in actions for negligence or other claims, no such action or claim need be described unless it departs from the normal kind of such actions.
- 2. No information need be given with respect to any proceeding that involves primarily a claim for damage if the amount involved, exclusive of interest and costs, does not exceed 10 percent of the current assets of the registrant and its subsidiaries on a consolidated basis. However, if any proceeding presents in large degree the same legal and factual issues as other proceedings pending or known to be contemplated, the amount involved in such other proceedings shall be included in computing such percentage.
- 3. Notwithstanding Instructions 1 and 2, any material bankruptcy, receivership, or similar proceeding with respect to the registrant or any of its significant subsidiaries shall be described.
- 4. Any material proceedings to which any director, officer or affiliate of the registrant, any owner of record or beneficially of more than 5 percent of any class of voting securities of the registrant, or any associate of any such director, officer, affiliate of the registrant, or security holder is a party

adverse to the registrant or any of its subsidiaries or has a material interest adverse to the registrant or any of its subsidiaries also shall be described.

5. Notwithstanding the foregoing, an administrative or judicial proceeding (including, for purposes of A and B of this Instruction, proceedings which present in large degree the same issues) arising under any Federal, State or local provisions that have been enacted or adopted regulating the discharge of materials into the environment or primarily for the purpose of protecting the environment shall not be deemed "ordinary routine litigation incidental to the business" and shall be described if: A. Such proceeding is material to the business or financial condition of the registrant; B. Such proceeding that involves primarily a claim for damages, or involves potential monetary sanctions, capital expenditures, deferred charges or charges to income and the amount involved, exclusive of interest and costs that exceeds 10 percent of the current assets of the registrant and its subsidiaries on a consolidated basis shall be disclosed; or C. Disclosure also is required if a A-governmental authority is a party to such proceeding and such proceeding involves potential monetary sanctions, unless the registrant reasonably believes that such proceeding will result in no monetary sanctions, or in monetary sanctions, exclusive of interest and costs, of less than \$100,000; provided, however, that such proceedings which are similar in nature may be grouped and described generically.

We recommend that Item 103 of Regulation S-B be modified as follows:

Item 103. Legal Proceedings

- (a) If a small business issuer is a party to any pending legal proceeding (or its property is the subject of a pending legal proceeding), In describing legal proceedings required under generally accepted accounting principles, give the following information (no information is necessary as to routine litigation that is incidental to the business):
- (1) name of court or agency where proceeding is pending;
- (2) date proceeding began;
- (3) principal parties;
- (4) description of facts underlying the proceedings; and
- (5) relief sought.

(b) Include the information called for by paragraphs (a)(1) through (5) of this Item for any proceeding that a governmental authority is contemplating (if the small business issuer is aware of the proceeding).

Instructions to Item 103.

- 1. A proceeding that primarily involves a claim for damages does not need to be described if the amount involved, exclusive of interest and costs, does not exceed 10% of the current assets of the small business issuer. If any proceeding presents the same legal and factual issues as other proceedings pending or known to be contemplated, the amount involved in such other proceedings shall be included in computing such percentage.
- 2. The following types of proceedings with respect to the registrant are not "routine litigation incidental to the business" and, notwithstanding instruction 1 of this Item, must be described: bankruptcy, receivership, or similar proceeding.
- 3. Any proceeding that involves federal, state or local environmental laws must be described if it is material; involves a damages claim for more than 10% of the current assets of the issuer; or potentially involves more than \$100,000 in sanctions and a governmental authority is a party.
- 4. Disclose any material proceeding to which any director, officer or affiliate of the issuer, any owner of record or beneficially of more than 5% of any class of voting securities of the small business issuer, or security holder is a party adverse to the small business issuer or has a material interest adverse to the small business issuer.

We recommend that Item 8.A.7 of Form 20-F be modified as follows:

7. Provide information on any legal or arbitration proceedings, including those relating to bankruptcy, receivership or similar proceedings, and those involving any third party, which may have, or Also describe any legal or arbitration proceedings which have had in the recent past, significant effects on the company's financial position or profitability. This includes governmental proceedings pending or known to be contemplated.

Disclosures of Risks Related to Financial Instruments. FASB Statements No. 105, Disclosure of Information about Financial Instruments with Off-Balance-Sheet Risk and Financial Instruments with Concentrations of Credit Risk, No. 119, Disclosure about Derivative Financial Instruments and Fair Value of Financial Instruments, and

No. 133, Accounting for Derivative Instruments and Hedging Activities, AICPA Statement of Position 94-6, Disclosure of Certain Significant Risks and Uncertainties, and the SEC's recent disclosure guidance about market risk, Disclosure of Accounting Policies for Derivative Financial Instruments and Derivative Commodity Instruments and Disclosure of Quantitative and Qualitative Information about Market Risk Inherent in Derivative Financial Instruments, Other Financial Instruments, and Derivative Commodity Instruments

Nature of Redundancy

We compared the disclosures required by the SEC's market risk rules and by various GAAP pronouncements about concentrations of credit risk and other risks related to financial instruments. Because the SEC's rules are generally prospective in nature, there were few redundancies. Those identified relate primarily to qualitative disclosures about derivative financial instruments, including a description of the instrument and the company's objectives for holding or issuing derivative instruments.

Working Group Recommendation

The SEC staff has stated their intention to revisit, and potentially amend, the market risk rules after the effective date of Statement 133. Because of the staff's stated intention of revising the market risk rules, we elected to defer further study in this area.

Disclosure requirements about risks and uncertainties arise from a number of different sources. We believe that potential redundancies in this area could be reduced if the accounting profession were able to define more clearly the types of circumstances and situations that constitute financial statement "risk."

Related Party Transactions. FASB Statement No. 57, *Related Party Disclosures*, and Regulation S-K Item 404, "Certain Relationships and Related Transactions," Item 404 of Regulation S-B, "Certain Relationships and Related Transactions," and Item 7.B of Form 20-F, "Related Party Transactions"

Nature of Redundancy

Certain requirements of Regulation S-K Item 404, Regulation S-B Item 404, and Item 7.B of Form 20-F are redundant with the disclosure provisions contained in paragraph 2 of Statement 57, including a description of the transaction, the nature of the relationship, and the amount of the transaction. The disclosures required by Statement 57 are broad guidelines as to the nature and type of transactions that should be disclosed. Statement 57 also contains definitions of the sorts of relationships that would constitute a "related party."

The disclosure guidance contained in Item 404 of Regulation S-K and the other references noted above is much more detailed and includes interpretative and computational guidelines for certain of the required disclosures, for example, a definition of a person's immediate family that includes "such person's spouse; parents; children; siblings; mothers and fathers-in-law; sons and daughters-in-law; and brothers and sisters-in-law."

Working Group Recommendation

There are a number of redundancies among these GAAP and SEC disclosure requirements. We recommend that Statement 57 be revised to incorporate certain of the more specific language contained in Item 404 of Regulation S-K, including adding *promoters* and *director nominees* to the definition of *related parties* in the glossary to Statement 57.

Related parties. Affiliates of the enterprise; entities for which investments are accounted for by the equity method by the enterprise; trusts for the benefit of employees, such as pension and profit-sharing trusts that are managed by or under the trusteeship of management; principal owners of the enterprise; its management; members of the immediate families of principal owners of the enterprise and its management; promoters and director nominees of the enterprise; and other parties with which the enterprise may deal if one party controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interests. Another party also is a related party if it can significantly influence the management or operating policies of the transacting parties or if it has an ownership interest in one of the transacting parties and can significantly influence the other to an extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests.

In addition, Item 404 of Regulations S-K and S-B employs a 5 percent threshold for purposes of determining whether a shareholder is a *related party*, whereas Statement 57 uses a 10 percent benchmark in its definition of *principal owner*. We suggest that the two be conformed and, accordingly, recommend that the threshold in Statement 57 be lowered.

e. **Principal owners.** Owners of record or known beneficial owners of more than 510 percent of the voting interests of the enterprise.

If those revisions are made to Statement 57, we suggest that the following deletions be made to Item 404 of Regulation S-K:

Item 404. Certain Relationships and Related Transactions.

Transactions with management and others: Describe briefly any transaction or series of similar transactions, since the beginning of the registrant's last fiscal year, or any currently proposed transaction, or series of similar transactions, to which the registrant or any of its subsidiaries was or is to be a party, in which the amount exceeds \$60,000. and in which any of the following persons had, or will have, a direct or indirect material interest, naming such person and indicating the person's relationship to the registrant, the nature of such person's interest in the transaction(s), the amount of such transaction(s) and, where practicable, the amount of such person's interest in the transaction(s):

- (1) Any director or executive officer of the registrant;
- (2) Any nominee for election as a director;
- (3) Any security holder who is known to the registrant to own of record or beneficially more than five percent of any class of the registrant's voting securities; and
- (4) Any member of the immediate family of any of the foregoing persons.
- (5) Any trust or other estate in which any of the persons specified in paragraph (c) (1) or (2) has a substantial beneficial interest or as to which such person serves as a trustee or in a similar capacity.

The detailed instructions to this Item that provide computational guidance and clarification of those relationships within the scope of the Item would remain unchanged, except for the references to the above paragraphs.

We recommend that Item 404 of Regulation S-B be modified as follows:

Item 404. Certain Relationships and Related Transactions.

(a) Describe any transaction during the last two years, or proposed transactions, to which the small business issuer was or is to be a party, in which any <u>related party of the following persons</u> had or is to have a direct or indirect material interest. Give the name of the person, the relationship to the

issuer, nature of the person's interest in the transaction and, the amount of such interest if the amount of the transaction, or series of transactions, exceeds \$60,000.

- (1) Any director or executive officer of the small business issuer;
- (2) Any nominee for election as a director;
- (3) Any security holder named in response to Item 403; and
- (4) Any member of the immediate family (including spouse, parents, children, siblings, and in-laws) of any of the persons in paragraphs (a)(1), (2) or (3) of this Item.
- (b) No information need be included for any transaction where:
- (1) Competitive bids determine the rates or charges involved in the transaction:
- (2) The transaction involves services at rates or charges fixed by law or governmental authority;
- (3) The transaction involves services as a bank depositary of funds, transfer agent, registrar, trustee under a trust indenture, or similar services;
- (4) The amount involved in the transaction or a series of similar transactions does not exceed \$60,000; or
- (5) The interest of the person arises solely from the ownership of securities of the small business issuer and the person receives no extra or special benefit that was not shared equally (pro rata) by all holders of securities of the class.
- (c) List all parents of the small business issuer showing the basis of control and as to each parent, the percentage of voting securities owned or other basis of control by its immediate parent, if any.
- (d) Transactions with promoters. Issuers organized within the past five years shall:
- (1) State the names of the promoters, the nature and amount of anything of value (including money, property, contracts, options, or rights of any kind) received or to be received by each promoter, directly or indirectly, from the

issuer and the nature and amount of any assets, services or other consideration therefore received or to be received by the registrant; and

(2) As to any assets acquired or to be acquired from a promoter, state the amount at which the assets were acquired or are to be acquired and the principle followed or to be followed in determining such amount and identify the persons making the determination and their relationship, if any, with the registrant or any promoter. If the assets were acquired by the promoter within two years prior to their transfer to the issuer, also state the cost thereof to the promoter.

Instructions to Item 404.

- 1. A person does not have a material indirect interest in a transaction within the meaning of this Item where:
- (a) The interest arises only:
- (1) from such person's position as a director of another corporation or organization (other than a partnership) which is a party to the transaction and/or
- (2) from the total ownership (direct or indirect) by all specified persons of less than a 10% equity interest in another person (other than a partnership) which is a party to the transaction;
- (b) The interest arises only from such person's position as a limited partner in a partnership in which he and all other specified persons had an interest of less than 10 percent; or
- (c) The interest of such person arises solely from holding an equity interest (but not a general partnership interest) or a creditor interest in another person that is a party to the transaction and the transaction is not material to such other person.
- 2. Include information for any material underwriting discounts and commissions upon the sale of securities by the small business issuer where any of the specified persons was or is to be a principal underwriter or is a controlling person or member of a firm that was or is to be a principal underwriter.
- 3. As to any transaction involving the purchase or sale of assets by or to the small business issuer otherwise than in the ordinary course of business, state

the cost of the assets to the purchase and if acquired by the seller within two years before the transaction, the cost thereof to the seller.

We recommend that Item 7.B of Form 20-F be modified as follows:

B. Related party transactions.

Provide the information required below for the period since the beginning of the company's preceding three financial years up to the date of the document, with respect to transactions or loans between the company and a related party.(a) enterprises that directly or indirectly through one or more intermediaries, control or are controlled by, or are under common control with, the company; (b) associates; (c) individuals owning, directly or indirectly, an interest in the voting power of the company that gives them significant influence over the company, and close members of any such individual's family; (d) key management personnel, that is, those persons having authority and responsibility for planning, directing and controlling the activities of the company, including directors and senior management of companies and close members of such individuals' families; and (e) enterprises in which a substantial interest in the voting power is owned, directly or indirectly, by any person described in (e) or (d) or over which such a person is able to exercise significant influence. This includes enterprises owned by directors or major shareholders of the company and enterprises that have a member of key management in common with the company. Close members of an individual's family are those that may be expected to influence, or be influenced by, that person in their dealings with the company. An associate is an unconsolidated enterprise in which the company has a significant influence or which has significant influence over the company. Significant influence over an enterprise is the power to participate in the financial and operating policy decisions of the enterprise but is less than control over those policies. Shareholders beneficially owning a 10% interest in the voting power of the company are presumed to have a significant influence on the company.

- 1. The nature and extent of any transactions or presently proposed transactions which are material to the company or the related party, or any transactions that are unusual in their nature or conditions, involving goods, services, or tangible or intangible assets, to which the company or any of its parents or subsidiaries was a party.
- 2. The amount of outstanding loans (including guarantees of any kind) made by the company or any of its parent or subsidiaries to or for the benefit of

any of the persons listed above. The information given should include the largest amount of any outstanding loan with a related party during the period covered, the amount outstanding as of the latest practicable date, the nature of the loan and the transaction in which it was incurred, and the interest rate on the loan.

Earnings per Share Computations. FASB Statement No. 128, *Earnings per Share*, Regulation S-K Item 601(b)(11), "Statement re Computation of Per Share Earnings," and Item 601(b)(3), Exhibit (11) of Regulation S-B, "Statement re Computation of Per Share Earnings"

Nature of Redundancy

The provisions of Regulation S-K Item 601(b)(11) that require the presentation of the computation of earnings per share are redundant with those in paragraph 40 of Statement 128. However, the FASB staff has advised constituents that this disclosure is only required in *annual* financial statements. Accordingly, this redundancy only arises with respect to filings of annual financial statements.

Working Group Recommendation

We believe that this computation should be mandated only at the end of the fiscal year, unless a registrant has a significant change in its capital structure that would have materially changed the number of common shares or potential common shares outstanding since the end of the prior fiscal period.

We also observe that the provisions of the SEC's disclosure requirement have not been updated to reflect the issuance of Staff Accounting Bulletin No. 98, *Revision of Certain SAB Topics to Reflect the Provisions of Statement of Financial Accounting Standards (SFAS) No. 128, Earnings per Share and SFAS No. 130, Reporting Comprehensive Income*, in February 1998. The Working Group therefore recommends that Regulation S-K Item 601(b)(11) be revised as follows:

Statement re computation of per share earnings. In accordance with the applicable provisions of generally accepted accounting principles, the registrant shall provide a schedule detailing A statement setting forth in reasonable detail the computation of per share earnings, unless the computation can be clearly determined from the material contained in the registration statement or report.

Interim filings need not include this disclosure unless the registrant is involved in a transaction that would have changed materially the total num-

ber of common shares or potential common shares outstanding since the end of the prior fiscal period or any of the components that comprise weighted shares outstanding. Examples of these kinds of transactions include the issuance or acquisition of common shares; the issuance of warrants, options, or convertible securities; the resolution of a contingency pursuant to a contingent stock agreement; and the conversion exercise of potential common shares outstanding at the end of the prior fiscal period into common shares. The information with respect to the computation of per share earnings on both primary and fully diluted bases, presented by exhibit or otherwise, must be furnished even though the amounts of per share earnings on the fully diluted basis are not required to be presented in the income statement under the provisions of Accounting Principles Board Opinion No. 15. That Opinion provides that any reduction of less than 3% need not be considered as dilution (see footnote to paragraph 14 of the Opinion) and that a computation on the fully diluted basis which results in improvement of earnings per share not be taken into account (see paragraph 40 of the Opinion).

We recommend that Regulation S-B Item 601(b)(3), Exhibit (11) be modified as follows:

Item 601. Exhibits

- (b) Description of exhibits. Below is a description of each document listed in the exhibit table.
- (11) Statement re computation of per share earnings. The registrant shall provide a schedule detailing An explanation of the computation of per share earnings on both a primary and fully diluted basis unless the computation can be clearly determined from the registration statement or report. Interim filings need not include this disclosure unless the registrant is involved in a transaction that would have changed materially the total number of common shares or potential common shares outstanding since the end of the prior fiscal period or any of the components that comprise weighted shares outstanding. Examples of these kinds of transactions include the issuance or acquisition of common shares; the issuance of warrants, options, or convertible securities; the resolution of a contingency pursuant to a contingent stock agreement; and the conversion exercise of potential common shares outstanding at the end of the prior fiscal period into common shares.

Research and Development Expenses. FASB Statement No. 2, *Accounting for Research and Development Costs*, and Regulation S-K Item 101(c)(xi), "Narrative Description of Business," Item 101(b)(10) of Regulation S-B, "Business of Issuer" (research and development section), and Item 5.C of Form 20-F, "Research and Development, Patents and Licenses, etc."

Nature of Redundancy

The requirements of Regulation S-K Item 101(c)(xi) about research and development expenses are largely redundant with the requirements of paragraph 13 of Statement 2 about disclosure of total research and development costs charged to expense for each period presented.

Working Group Recommendation

We recommend the following revisions to Regulation S-K Item 101(c)(xi):

(xi) If material, the estimated amount spent during each of the last three fiscal years on company sponsored research and development activities determined in accordance with generally accepted accounting principles. In addition, state, if material, the estimated dollar amount spent during each of such the last three fiscal years on customer-sponsored research activities relating to the development of new products, services or techniques or the improvement of existing products, services or techniques.

We recommend that Item 101(b)(10) of Regulation S-B be modified as follows:

Item 101. Description of Business.

(10) If material, the estimated dollar Estimate of the amount spent during each of the last two fiscal years on research and development activities, and if applicable to the extent to which the cost of such activities are borne directly by customers and relate to the development of new products, services or techniques or the improvement of existing products, services or techniques.

We recommend that Item 5.C of Form 20-F be modified as follows:

C. Research and development, patents and licenses, etc. Provide a description of the company's research and development polices for the last

three years, where it is significant, including the amount spent during each of the last three financial years on company sponsored research and development activities.

Segment Information. FASB Statement No. 131, *Disclosures about Segments of an Enterprise and Related Information*, and Regulation S-K Item 101(b), "Financial Information about Segments," Item 101(d), "Financial Information about Geographic Areas," and Item 4.B.2 of Form 20-F, "Business Overview"

Nature of Redundancy

Certain of the disclosure requirements of Regulation S-K Item 101 are redundant with the requirements of paragraphs 25 and 27 of Statement 131 for disclosures about revenues, profit or loss, and total assets by segment.

Working Group Recommendation

We recommend that the SEC disclosure requirements be eliminated. As a consequence, the only portion of Item 101(b) that would remain is the disclosure requirement about major customers (see suggested revision to Statement 131 above). Regulation S-K Item 101(b) would be revised as follows:

- (b) Financial information about segments. Report for each segment, as defined by generally accepted accounting principles, revenues from external customers, a measure of profit or loss and total assets. A registrant must report this information for each of the last three fiscal years or for as long as it has been in business, whichever period is shorter. If the information provided in response to this paragraph (b) conforms with generally accepted accounting principles, a registrant may include in its financial statements a cross reference to this data in lieu of presenting duplicative information in the financial statements; conversely, a registrant may cross reference to the financial statements.
- (1) If a registrant changes the structure of its internal organization in a manner that causes the composition of its reportable segments to change, the registrant must restate the corresponding information for earlier periods, including interim periods, unless it is impracticable to do so. Following a change in the composition of its reportable segments, a registrant shall disclose whether it has restated the corresponding items of segment information for earlier periods. If it has not restated the items from earlier periods, the registrant shall disclose in the year in which the change occurs

segment information for the current period under both the old basis and the new basis of segmentation, unless it is impracticable to do so.

- (d) Financial information about geographic areas. (1) State for each of the registrant's last three fiscal years, or for each fiscal year the registrant has been engaged in business, whichever period is shorter:
 - (i) Revenues from external customers attributed to:
 - (A) The registrant's country of domicile;
- (B) All foreign countries, in total, from which the registrant derives revenues; and
- (C) Any individual foreign country, if material. Disclose the basis for attributing revenues from external customers to individual countries.
- (ii) Long lived assets, other than financial instruments. Long term customer relationships of a financial institution, mortgage and other servicing rights, deferred policy acquisition costs, and deferred tax assets, located in:
 - (A) The registrant's country of domicile;
 - (B) All foreign countries, in total, in which the registrant holds assets; and
 - (C) Any individual foreign country, if material.
- (2) A registrant shall report the amounts based on the financial information that it uses to produce the general purpose financial statements. If providing the geographic information is impracticable, the registrant shall disclose that fact. A registrant may wish to provide, in addition to the information required by paragraph (d)(1) of this section, subtotals of geographic information about groups of countries. To the extent that the disclosed information conforms with generally accepted accounting principles, the registrant may include in its financial statements a cross reference to this data in lieu of presenting duplicative data in its financial statements; conversely, a registrant may cross reference to the financial statements.
- (3) A registrant shall describe any risks attendant to the foreign operations and any dependence on one or more of the registrant's segments upon such foreign operations, unless it would be more appropriate to discuss this

information in connection with the description of one or more of the registrant's segments under paragraph (c) of this item.

(4) If the registrant includes, or is required by Article 3 of Regulation S-X, to include, interim financial statements, discuss any facts relating to the information furnished under this paragraph (d) that, in the opinion of management, indicate that the three year financial data for geographic areas may not be indicative of current or future operations. To the extent necessary to the discussion, include comparative information.

We recommend the following change to Item 4.B.2 of Form 20-F:

2. A description of the principal markets in which the company competes, including a breakdown of total revenues by category of activity and geographic market for each of the last three financial years.

Disclosure of Allowances for Doubtful Accounts. Accounting Principles Board No. 12, *Omnibus Opinion—1967*, and Regulation S-X Article 5-02.4, "Allowances for Doubtful Accounts and Notes Receivable"

Nature of Redundancy

The requirements of Regulation S-X Article 5-02.4 for disclosure of allowances for doubtful accounts are redundant with paragraph 3 of Opinion 12, which requires the identical disclosure.

Working Group Recommendation

We recommend that Regulation S-X Article 5-02.4 be deleted in its entirety, as follows:

(4) Allowances for doubtful accounts and notes receivable. The amount to be set forth separately in the balance sheet or in a note thereto.

We note that the SEC staff has recently placed greater emphasis on registrants' disclosures about reserves, including allowances for doubtful accounts and notes receivable. We do not believe that our recommendation to eliminate the redundant disclosure requirement will impede the staff's efforts in this area because Opinion 12 will still require registrants to disclose allowances. We also observe that the SEC has recently issued a proposed rule change that would require more extensive disclosures about changes in valuation and loss accrual accounts that would encompass allowances for doubtful accounts. The adoption of that proposed rule would have no impact on our recommendation to eliminate the redundancy identified above.

CHAPTER 2—PREVENTING FUTURE REDUNDANCIES

Although a periodic effort to identify disclosure redundancies and recommend their elimination is useful, the need for such periodic reviews could be reduced through a change in the way in which GAAP accounting standards and SEC disclosure rules are developed.

One of the activities undertaken by the FASB project team that works to develop an accounting standard should be to identify whether the standard creates a redundancy with existing SEC rules. The SEC staff who are following the FASB project could assist the FASB staff in this activity. If a redundancy is identified, the FASB and SEC staffs should determine a way to eliminate it before a new standard is issued.

One of the activities undertaken in an SEC rule proposal effort should be to identify whether the rule creates a redundancy with existing GAAP. The SEC staff could ask the FASB for assistance in this effort. If a redundancy is identified, the SEC staff should consider whether they believe the redundancy is needed or if a reference to the GAAP requirement would be sufficient.

CHAPTER 3—RECOMMENDATIONS WITH RESPECT TO GUIDE 3, STATISTICAL DISCLOSURE BY BANK HOLDING COMPANIES

The SEC's Regulation S-K includes a series of Industry Guides that include disclosure requirements focused on certain industries. The GAAP-SEC Disclosures Working Group was asked to study one of the Guides. The Working Group chose to study Guide 3, *Statistical Disclosure by Bank Holding Companies*, because of the significant changes in the banking industry and GAAP since Guide 3 was issued. Additionally, two members of the Working Group had significant experience with Guide 3.

The study of Guide 3 differs from the effort to identify redundancies as discussed in Chapter 1. The Working Group undertook a critical review of the usefulness and relevance of the information required by Guide 3.

Methodology Used to Study Guide 3

The following are the steps undertaken to study Guide 3.

- We prepared a summary of the principal disclosure requirements of Guide 3, noting GAAP and SEC disclosure redundancies and information that we believed was used by investors and analysts for similar purposes.
- We reviewed a large multinational bank holding company's annual report and Form 10-K, noting the source of each disclosure requirement in them.
- We developed a survey for selected users to test the usefulness of existing Guide 3
 disclosures. We asked representatives of the Investor Relations Department at the Chase
 Manhattan Corporation and eight other financial statement users, primarily bank
 analysts, to participate in completing our survey.
- Four users responded to our survey (a response rate of 44 percent). Because the results from those respondents were similar, we elected not to continue to pursue those who had initially agreed to participate in our survey but failed to respond on a timely basis.
- We reviewed our proposed recommendations with a group of analysts who were not included in our survey.
- We discussed our observations and recommendations with the SEC staff and learned that the SEC staff, in conjunction with certain other federal agencies, is working on a similar project to review Guide 3.

Overview of Guide 3 Requirements

Guide 3 was adopted by the SEC in the early 1980s in response to analysts' concerns that insufficient information was available to make informed decisions about a bank's financial position and results of operations. Guide 3 requires disclosure of information about lending and investment activity that was incremental to disclosures required by GAAP at that

time. Since its adoption, changes in GAAP accounting and disclosure requirements have affected the relevance and usefulness of many of the Guide 3 disclosure requirements. In practice, those disclosures are generally made outside the financial statements.

Guide 3 comprises seven elements, as follows:

- Distribution of assets, liabilities and stockholders' equity; interest rates and interest differential
- Investment portfolio
- Loan portfolio
- Summary of loan loss experience
- Deposits
- Return on equity and assets
- Short-term borrowings.

Notwithstanding its title, Guide 3 applies to all public companies engaged in deposit taking or significant lending activity. Therefore, it applies to bank holding companies, thrift holding companies, and other entities engaged in significant lending and financing activities, such as mortgage lenders and consumer finance companies. We observe that financial institutions other than bank and thrift holding companies generally make an effort to comply with the disclosure requirements of Guide 3, however, their level of adherence varies significantly.

Recommendations

Our recommendations on Guide 3 can be classified in four broad categories:

- Requirements of Guide 3 that are addressed explicitly or implicitly by GAAP requirements (for example, fair value disclosures in Statement 105 and segment disclosures in Statement 131)
- 2. Items that should be modified to reflect changes in GAAP (that is, those required by the issuance of Statements 105, No. 107, Disclosures about Fair Value of Financial Instruments, No. 114, Accounting by Creditors for Impairment of a Loan, No. 115, Accounting for Certain Investments in Debt and Equity Securities, No. 118, Accounting by Creditors for Impairment of a Loan—Income Recognition and Disclosures, and 133)
- Disclosures that may no longer be relevant due to changes in the marketplace or regulatory environment (for example, deposit analysis, short-term borrowing analysis, and average balance sheets including interest cost and yield)
- Disclosures that should be retained but modified to reflect current GAAP requirements (for example, analysis of changes in loan loss).

Recommendations with Respect to Guide 3

As noted above, we surveyed several financial statement users as part of our work. In addition to soliciting their views on the usefulness of information required by Guide 3, we also sought their views about our preliminary recommendations for revisions to Guide 3. Our recommendations and related comments are set forth below.

Recommendation 1

Amend Guide 3 to delete requirements for separate disclosures of foreign and industry concentrations.

Comments

Various GAAP and SEC sources require disclosures that serve substantially the same purposes, including:

- FASB Statement No. 105, Disclosure of Information about Financial Instruments with Off-Balance-Sheet Risk and Financial Instruments with Concentrations of Credit Risk
- FASB Statement No. 131, Disclosures about Segments of an Enterprise and Related Information
- Regulation S-K Item 101, "Description of Business"
- Regulation S-K Item 303, "Management's Discussion and Analysis of Financial Condition and Results of Operations"
- Regulation S-K Item 305, "Quantitative and Qualitative Disclosures about Market Risk"
- SEC staff guidance contained in various speeches and interpretive and enforcement releases.

Recommendation 2

Eliminate Item I (A), "Requirement for Disclosures of Net Interest Earnings Analysis—Domestic," and Item I (B), "Requirement for Disclosures of Foreign and Domestic Changes in Net Income."

Comments

Two respondents to our survey believe that these disclosure requirements provide useful information. However, other respondents favor eliminating those disclosure requirements in Guide 3 and including the relevant information in management's discussion and analysis (MD&A).

Recommendation 3

Eliminate Item II, "Investment Portfolio," in its entirety.

Comments

Item II disclosures are duplicative of Statement 115 disclosure requirements. Survey respondents also advise us that they do not use Item II disclosures.

Recommendation 4

Eliminate Item III (A), "Types of Loans," and Item III (B), "Maturities and Sensitivity to Changes in Interest Rates."

Comments

Disclosures required by Item III (A) and (B) are, in practice, frequently redundant to those required by Statements 114 and 118. Survey respondents found the nature of the information useful, although not in the format provided. Two respondents indicated they typically obtain loan portfolio information sorted in "more useful" ways directly from companies. One respondent suggested that the SEC's market risk rules are more relevant than the disclosures required by Item III (B).

Recommendation 5

Amend Guide 3 to reduce disclosures required by Items III and IV, "Summary of Loan Loss Experience," from five years to three years.

Comments

Respondents consistently suggest that Guide 3 disclosures could be limited to a maximum of three years.

Recommendation 6

Eliminate Item VII, "Short-Term Borrowings," in its entirety.

Comments

The information required by Item VII is a subset of information required by the MD&A rules as they relate to requirements to provide information about long-term and short-term liquidity and capital resources. Survey respondents support elimination.

Recommendations with Respect to Guide 3

Areas for Future Study

At the request of the Steering Committee, we have identified the following specialized industries that have unique disclosure requirements and that may be candidates for future study:

- · Oil and gas
- Property and casualty underwriters
- Utilities
- Mining
- Real estate.

We observe that the methodology (outlined above) that we followed could serve as a guide for those who may undertake a similar task in the future. We also suggest that such a task could be undertaken by a committee under the sponsorship of the AICPA, similar to the committees that developed AICPA Industry Audit Guides in the past.

Appendix A

METHODOLOGY AND APPROACH USED TO IDENTIFY REDUNDANCIES

The Working Group undertook a detailed review of those accounting standards and SEC rules that we believed would yield the greatest number of redundancies. In building an inventory of redundant disclosures, we reviewed the following:

- Form and Content of and Requirements for Financial Statements, Securities Act of 1933, Securities Exchange Act of 1934, Public Utility Holding Company Act of 1935, Investment Company Act of 1940, and Energy Policy and Conservation Act of 1975 (Regulation S-X)
- Standard Instructions for Filing Forms under Securities Act of 1933, Securities Exchange Act of 1934, and Energy Policy and Conservation Act of 1975 (Regulation S-K)
- Standard Instructions for Filing Forms under Securities Act of 1933, Securities Exchange Act of 1934, and Energy Policy and Conservation Act of 1975—Integrated Disclosure System for Small Business Issuers (Regulation S-B)
- Reporting and Registration under the Securities and Exchange Act of 1934 (Form 20-F)
- International Disclosure Standards
- Statistical Disclosure by Bank Holding Companies (Guide 3)
- Disclosure of Accounting Policies for Derivative Financial Instruments and Derivative Commodity Instruments and Disclosure of Quantitative and Qualitative Information about Market Risk Inherent in Derivative Financial Instruments, Other Financial Instruments, and Derivative Commodity Instruments (SEC Market Risk Rules)
- Financial Accounting Standards of the Financial Accounting Standards Board
- Opinions of the Accounting Principles Board
- Accounting Research Bulletins of the Committee on Accounting Principles
- AICPA Accounting Interpretations
- FASB Interpretations
- Statements of Position issued by the American Institute of Certified Public Accountants
- Consensuses of the FASB Emerging Issues Task Force.

We also read previous correspondence between the SEC and past committees that worked to eliminate disclosure redundancies. Those documents include a letter dated February 9, 1979, from John J. Quinn, the chairman of the AICPA Committee on SEC Regulations, to A. Clarence Sampson, Chief Accountant of the SEC, and an analysis of potentially unnecessary SEC disclosure regulations submitted under cover of a letter dated

Appendix A

September 7, 1990, from C.P. Colwell, the chairman of the SEC Subcommittee of the Financial Executives Institute Committee on Corporate Reporting, to Edmund Coulson, Chief Accountant of the SEC.

CHAPTER 4—RECOMMENDATIONS TO IMPROVE THE STRUCTURE AND ORGANIZATION OF FORM 10-K

Form 10-K, the annual report filed by registrants with the SEC, is a key disclosure document. The GAAP-SEC Disclosures Working Group reviewed the current Form 10-K structure to identify changes that would improve its usefulness and readability.

The Role of Emerging Technology

In the early stages of this review, certain group members made observations on the rise of the Internet and the related trend toward electronic dissemination of financial information. Because of the rapidly expanding role of technology in today's information marketplace, traditional ideas about the "organization of information" may someday become obsolete. As a greater number of companies place financial information on their corporate websites, users have greater control over the portions of the report they choose to review and those they choose to disregard. Through the use of hyperlink technology and on-line search capabilities, investors are able to navigate within the annual report and bypass information they judge to be less useful. As these technologies develop, the sequence in which information is arranged in a traditional paper annual report might become increasingly less important.

We met with Wayne Upton, an FASB senior project manager and a member of the Working Group studying the electronic distribution of business information, to learn more about this subject. Mr. Upton provided us with an overview of the current practices of companies that use the Internet as a means of providing their annual reports and other financial information to shareholders and potential investors. We also met with securities attorneys to gain an understanding of the evolving law in this area and the current legal implications to companies and their auditors. Based on that meeting, we understand that traditional paper annual reports will continue to be prepared for the foreseeable future.

Approach

We decided to test our ideas about improving the presentation of financial information by applying them to a registrant's annual report. Our intentions were twofold: (a) to note duplicative disclosures that would be eliminated upon implementation of our recommendations to eliminate redundancies and (b) to revise the organization of data within the annual report to make it easier to use. We sought to create a reporting format that provided information to investors in a manner that was logical and that made relevant information easier to locate.

Chapter 4

In our early discussions about revising Form 10-K, we noted that our ability to revise the current reporting format, particularly as it related to the registrant's financial statements, would have to overcome concerns about:

- Audit coverage—Revisions to Form 10-K that involve moving information found
 within the audited financial statements, or including cross references to information
 in the audited financial statements, could potentially "blur the line" as to the level of
 responsibility that auditors bear for certain information within the 10-K.
- Limits of "safe harbor" provisions—The SEC has provided legal protection to registrants for certain forward-looking disclosures in the 10-K, and concerns might arise about similar disclosures that are in sections of the document that have not been afforded such protection, in particular, disclosures included in the financial statements.
- Non-GAAP financial statements—Some have observed that moving disclosures from
 the financial statements to other locations in Form 10-K could render the financial
 statements, on a stand-alone basis, non-GAAP due to incomplete or inadequate
 disclosure.
- Effect on private companies—We observed that certain of our recommendations could
 have an impact on private companies as a result of changes brought about by our
 proposed revisions to the pronouncements of the FASB and its predecessors.

Recommendations to Improve the Structure and Organization of Form 10-K

The following proposed Form 10-K format is organized so that the information we viewed as more important to users is placed at the front of the document. The majority of the revised format is primarily a reorganization of information included in the existing Form 10-K format. A summary of the reorganized format and a comparison with the existing Form 10-K format are set forth below:

Proposed Form 10-K Format	Existing Form 10-K Format
Our Business (new)	Business
Selected Financial Data	Properties
Risks and Uncertainties That May Affect Our Future Results	Legal Proceedings
Management's Discussion and Analysis of Segment Operations and Liquidity and Capital Resources	Submission of Matters to a Vote of Security Holders
Financial Statements	Market for the Registrant's Common Equity and Related Stockholder Matters
Corporate-Wide Matters	Selected Financial Data
Submission of Matters to a Vote of Security Holders	Management's Discussion and Analysis of Financial Condition and Results of Operations
Executive Officers of the Company	Quantitative and Qualitative Disclosures about Market Risk
Market for the Company's Equity and Related Stockholder Matters	Financial Statements and Supplementary Data
Changes in and Disagreements with Accountants on Accounting and Financial Disclosures	Changes in and Disagreements with Accountants on Accounting and Financial Disclosures
Directors and Executive Officers of the Company	Directors and Executive Officers of the Registrant
Executive Compensation	Executive Compensation
Security Ownership and Certain Beneficial Owners and Management	Security Ownership and Certain Beneficial Owners and Management
Certain Relationships and Related Transactions	Certain Relationships and Related Transactions
Exhibits	Exhibits, Financial Statement Schedules, and Reports on Form 8-K
Reports on Form 8-K	Signatures
Signatures	

Appendix B provides an example of this revised Form 10-K format.

CHAPTER 5—OBSERVATIONS ABOUT OTHER SEC DISCLOSURE REQUIREMENTS

During the course of the project, the Working Group identified a number of matters that, although not redundancies, were observed as being of limited usefulness or should be reconsidered. With the significant changes in the economy (for example, a greater emphasis on intangible assets, including intellectual capital) and the continuing interest by analysts and other users of financial information for more meaningful disclosures, the time may have come for a more comprehensive review of disclosures mandated by the SEC.

Disclosures about Equity Method Investees. APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*, and Regulation S-X Rule 3-09, "Separate Financial Statements of Subsidiaries Not Consolidated and 50 Percent or Less Owned Persons"

Both Opinion 18 and Regulation S-X include requirements for disclosures about significant equity investees. However, Opinion 18 does not provide specific guidance about the circumstances in which those disclosures are to be made. In contrast, the SEC rules provide explicit thresholds for those disclosures. To illustrate, paragraph 20(d) of Opinion 18 states:

When investments in common stock of corporate joint ventures or other investments accounted for under the equity method are, in the aggregate, material in relation to the financial position or results of operations of an investor, it may be necessary for summarized information as to assets, liabilities, and results of operations of the investees to be presented in the notes or in separate statements, either individually or in groups, as appropriate.

The Accounting Principles Board did not define such terms as *material in relation to the* . . . *investor* or *summarized information*. Additional clarification for public companies is provided by Rule 3-09 of Regulation S-X. A comparison of some of the disclosure provisions of Opinion 18 and Rule 3-09 is set forth below:

Chapter 5

	GAAP Requirement	RegulationS-X
Definition of material or significant investee	No	Yes
Financial statements required	Optional	Yes, if significance > 20%
Disclosures required:		
Summarized financial information	Yes	Yes
Summarized information defined	No	Yes
Name of investee	Yes	No
Percentage of ownership	Yes	No
Accounting policies of investor	Yes	No
Difference between book value and		
equity in net assets	Yes	No
Quoted market value where applicable	Yes	No
Material effects of possible conversions, exercises, or contingent issuances of		
investee stock	Yes	No

Based on the comparison above, we note that the financial statement and disclosure requirements for equity investees under GAAP and Regulation S-X are only truly redundant to the extent that both require financial information or financial statements about material or significant investees. However, the guidance about the circumstances in which information about equity investees is to be disclosed is inconsistent. Accordingly, a registrant must refer to two different sources to ensure that all required disclosures are made.

Working Group Observation

A study of the existing disclosures should be undertaken to (a) consolidate and harmonize the disclosure and financial statement requirements, (b) require that the information be provided in the footnotes to the financial statements, and (c) establish a common and objectively determinable threshold for disclosure requirements.

It is important to note that our observations, as set forth below, are based on the presumption that summarized information included within the footnotes of the investor-registrant's financial statements is more likely to be read than information located in the back of the document, even if that information is more extensive. We believe that this notion is supported by recent academic research, which indicates that prominent

Observations about Other SEC Disclosure Requirements

placement of information increases the likelihood it will be used by investors. While companies could also provide full financial statements for significant equity investees on a voluntary basis, our proposed amendments would result in the primary financial statements including expanded information about significant investees so that shareholders can analyze that information in the context of the full financial statements of the investor.

The Working Group's observations could be implemented as follows:

- Amend Opinion 18 to identify specific minimum financial information that must be provided for significant or material equity investees. Such definition could be similar to the current requirements in Regulation S-X Rule 1-02(bb)
- Amend Opinion 18 to require the summarized information to be provided in the footnotes to the financial statements of the investor/registrant
- Amend Opinion 18 to provide that summarized disclosure is required if (1) the investment in and advances to the equity investee, or the pro rata interest in the equity investee's assets, exceed 10% of the investor/registrant's total assets or (2) the investor/registrant's pro rata share of the equity investee's net income exceeds 10% of the investor/registrant's net income.

Specifically, paragraph 20 of Opinion 18 could be changed to read as follows:

Disclosures. The significance of an investment to the investor's financial position and results of operations should be considered in evaluating the extent of disclosures of the financial position and results of operations of an investee. If the investor has more than one investment in common stock, disclosures wholly or partly on a combined basis may be appropriate. The following disclosures are generally applicable to the equity method of accounting for investments in common stock:

- a. Financial statements of an investor should disclose parenthetically, in notes to financial statements, or in separate statements or schedules (1) the name of each investee and percentage of ownership of common stock, (2) the accounting policies of the investor with respect to investments in common stock, and (3) the difference, if any, between the amount at which an investment is carried and the amount of underlying equity in net assets and the accounting treatment of the difference.
- b. For those investments in common stock for which a quoted market price is available, the aggregate value of each identified investment based on the quoted market price usually should be disclosed. This disclosure is not required for investments in common stock of subsidiaries.

- c. When investments in unconsolidated subsidiaries are, in the aggregate, material in relation to financial position or results of operations, summarized information as to assets, liabilities, and results of operations should be presented in the notes or separate statements should be presented for such subsidiaries, either individually or in groups, as appropriate. For purposes of measuring materiality, the investment in the unconsolidated subsidiary is deemed material if (1) the company's and its other subsidiaries' investments in and advances to the subsidiary exceed 10 percent of the total assets of the company and its subsidiaries consolidated as of the most recently completed fiscal year-end, (2) the company's and its other subsidiaries' proportionate share of the total assets (after intercompany eliminations) of the subsidiary exceed 10 percent of the total assets of the company and its consolidated subsidiaries as of the end of the most recently completed fiscal year; or (3) the company's and its other subsidiaries' equity in the income from continuing operations before income taxes, extraordinary items, and cumulative effect of a change in accounting principle of the subsidiary exceeds 10 percent of such income of the company and its subsidiaries consolidated for the most recently completed fiscal year.
- d. When investments in common stock of corporate joint ventures or other investments of 50% or less accounted for under the equity method are, in the aggregate, material (as defined in (c) above) in relation to the financial position or results of operations of an investor, it may be necessary for summarized information as to assets, liabilities, and results of operations of the investees to be presented in the notes or in separate statements, either individually or in groups, as appropriate.
- e. Conversion of outstanding convertible securities, exercise of outstanding options and warrants and other contingent issuances of an investee may have a significant effect on an investor's share of reported earnings or losses. Accordingly, material effects of possible conversions, exercises or contingent issuances should be disclosed in notes to the financial statements of an investor.

Disclosure of Quarterly Stock Prices

Regulation S-K Item 201, "Market Price of and Dividends on the Registrant's Common Equity and Related Stockholder Matters," Item 201 of Regulation S-B, "Market for Common Equity and Related Stockholder Matters," and Item 9.A of Form 20-F, "Offer and Listing Details," require disclosure of the registrant's quarterly stock prices for the two most recent fiscal years. Many believe that in today's marketplace, when up-to-the-minute stock quotations are available on the Internet or through other means.

Observations about Other SEC Disclosure Requirements

this disclosure does not yield information that would likely be useful to an investor or other users of the registrant's financial statements. We therefore believe that it should be eliminated.

Information about Officers and Directors

Certain members of our Working Group suggested that the disclosure of officers and directors' ages required by Regulation S-K Item 401, "Directors, Executive Officers, Promoters and Control Persons," Item 401 of Regulation S-B, "Directors, Executive Officers, Promoters and Control Persons," and Item 6.A.3 of Form 20-F, "Directors and Senior Management," be eliminated. They do not believe that the information is relevant, as it does not assist investors or other users of financial statements in making investment decisions. Others in the group believe that, in certain circumstances, the information could materially affect an investor's decision. Because of those differing views, the members of the Working Group were unable to reach a consensus on this issue.

Number of Employees

Some of our members also stated their belief that disclosures about a registrant's employees, as required by Regulation S-K Item 101(c)(xiii) and Item 101(b)(12) of Regulation S-B provide less useful information than in the past, particularly in today's marketplace when many companies are outsourcing certain operations or retaining individuals on a part-time basis. They noted that in those circumstances such a disclosure could even be misleading. We therefore believe that the disclosure requirement could be made more robust. Regulation S-K Item 101(c)(xiii) could be revised as follows:

(xiii) The number of personsemployees employed by the registrant. Separate disclosure should be made of the number of employees who are employed on a part-time basis and those who are employed subject to lease or co-employment agreements.

Regulation S-B Item 101(b)(12) could be similarly revised as follows:

(12) Number of total employees and number of full time employees. <u>Separate disclosure should also be made of the number of employees who are employed subject to lease or co-employment agreements.</u>

Chapter 5

Properties

For a number of companies, the disclosures about properties required by Regulation S-K Item 102, Regulation S-B Item 102, and portions of Item 4.D of Form 20-F are less relevant today than when this disclosure requirement was enacted. For example, many users of financial statements are vocal in requesting more information about intellectual capital and other intangible assets. Given those sorts of demands, detailed disclosures about properties may—for certain industries—be an anachronism. Others have suggested that disclosures about properties should be restricted to related risk factors, for example, dependence on a small number of manufacturing sites. We therefore believe that detailed disclosures about properties may be more appropriate as a requirement of certain specialized industry guides, for example, those covering industries in which those disclosures may be critical to investors, such as the mining or oil and gas industries.

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