REPORTING DEVELOPMENTS AT THE SEC AND THEIR IMPACT ON ANNUAL REPORTS

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Thank you very much. I'm glad you asked me to tell you how I see it as opposed to the title which infers it will be as the SEC sees it since, as I said yesterday, the Commission doesn't let me speak for the SEC, and my points must be personal in the context in which I give them to you. It is quite fortunate timing that brings me here to talk about the annual report to shareholders only two weeks after the SEC took some actions to revise some of its own reports to make the annual report more important in the scheme of registration with the Commission and in selling securities. We have given it, and intend to give it greater emphasis in that respect. We believe that United States annual reports in general, at least partially as a result of SEC influence, have become pretty well balanced now in terms of completeness of information without being overly detailed. I speak pretty much about financial information as opposed to other kinds of information that very sophisticated investors would want. As I think we had some indication yesterday, the Commission's authority to require information does not go to things that

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are not valuable to stockholders or analysts in terms of investment decisions. Unless we can conclude that an investor needs information about employees for instance, or about the environment, which is a big thing in our country as well as around the world, we could not require it to be furnished in reports. We do have persons who ask us at times to require information from companies in this area, and the Commission has had to say that it does not have the authority to go as far as some people would like us to go.

It was the quality of the annual reports in our country, I believe, that led the Commission to now adopt the annual report to shareholders as the primary building block for what we call integration of the Securities Acts. As most of you know, we have had two kinds of reports in the United States -- an annual report which is filed with the Commission every year by all registered companies (about ten thousand companies) and a Securities Act filing to sell securities. In the past the report to sell securities (the '33 Act report) was much more detailed than the '34 Act reports. But over the past ten years the Commission has been requiring more information in the 10-K and these two reports have been coming closer together. Now we are taking steps to make them almost the same in that sense.

Before looking at some of the specifics of that proposal, you might be interested in a bit of background. As a matter of

fact, the securities acts do not specifically authorize the Commission to tell companies to put any particular information in an annual report to shareholders. The Commission is authorized, however, to require companies to send information to shareholders before they hold an annual meeting at which directors are to be elected. It is in that context that we are able to tell companies what should be in the annual report to shareholders. Up until the early 1960's, the Commission took virtually no interest, at least no direct interest, in what went into the annual report. In the early 60's, a particular matter came to our attention which focused attention on annual reports, and we heard a reference to it yesterday from some companies which put parent company financial statements in their annual report and consolidated financial statements elsewhere, or not at all. In the early 60's, which was right after I went with the Commission, we had a company which in its parent company financial statements, which had been sent to all shareholders, showed profits, and its 10-K statements (which were consolidated) filed with the Commission, showed losses. There were some other factors involved and we had to investigate that case, and took appropriate action, but it was that case that particularly focused the Commission's attention on annual reports. In 1964 we amended the proxy rules to require not that the financial statements be the same as those in the 10-K, but

that if there were differences, those differences had to be reconciled and spelled out in the annual report to shareholders. A consequence of that was that in substance anyway, financial statements were about the same, both in annual reports and in Commission filings. As time went on, the Commission's interest in what went into the annual report became greater, and in 1974 they took another major step by requiring certain minimum content of information in annual reports. Broadly, some of the major areas were a requirement for two year financial statements, a summary of operations for five years, something we call a management discussion and analysis of operations, which I'll talk more about later, a business description, lines of business, information about executive officers and directors and identification of security markets where the securities were sold. We adopted this minimum content for the report but without any specifics in terms of it being the same as what was in the 10-K. In 1977, an advisory committee set up by the Commission, the Advisory Committee on Corporate Disclosure, recommended that we merge the 10-K in the annual report to shareholders and make them about the same so that companies would talk to their shareholders in the annual report as opposed to putting the information in the Commission's files where it was available if you want to come to Washington to look at it, or if you

were willing to pay for the reproduction of it to be sent out to you. The Commission did not take the step of merging them totally. It did require that companies offer 10-K reports to all their shareholders without charge, but it permitted companies to charge reasonable fees for copies of exhibits to the 10-K. A very small number of people asked for 10-K's, really a very small number. They are generally only used by analysts and a few stockholders and by University classes, from time to time, to study companies. The Commission did not merge the 10-K in the annual report and is still not doing so. One of the reasons is that it is concerned about the readibilty of annual reports to shareholders. Throughout its history, it has been conscious of the difference that we find in annual reports to shareholders and 10-K's or even securities act filings with the Commission, because, with due apologies to any lawyers in the audience, when the lawyers get a hold of things they become much more difficult to read and to understand.

We heard yesterday some reference to information overload. This is a question which concerns all of the Commissioners. Indeed, every time we consider whether to adopt new rules, we must be concerned about cost, both in generating information and in publishing, reprinting and mailing information, and in the ability of stockholders to read and understand

information. As you heard talk about telephone books yesterday, we hear that as well, and if you give an average stockholder a "book" two inches thick, he is likely not to look at it at all. So we are concerned about keeping the material furnished to them a smaller size.

The Commission's action in September revised some of the existing requirements in 10-K's and in annual reports. In order to facilitate integration, as I indicated before, we are attempting to make the annual report to shareholders complete enough to enable it to be used as the basic disclosure document, if the company really wants to, in filings with the Commission. In our initial proposals, we urged people, through our commentary, to think about incorporating by reference material from the annual report to the 10-K, not just the financial statements but the description of business, management's discussion and various other things in the annual report. We got a lot of protests about that, which related to readability as well as liability. To what extent specific incorporation in a Securities Act filing would result in Securities Act liability of the company's officers and directors for the annual report is not known. As all of you know, the courts in the United States are probably more active than anywhere in the world in terms of liability and third party suits. We did not really believe that it would change liability simply because they incorporated

some words from the annual reports into the 10-K's but the possibility obviously created a problem in people's minds. In the release announcing the adoption of the new rules, we went out of our way to assure people that there was no requirement to incorporate by reference. They may put the information in the annual report, and then put the same information in a more detailed description in the 10-K. They can incorporate the annual report into the 10-K if they wish to. The only information that is required to be the identical in the 10-K and the annual report to shareholders is the financial statements themselves. The Commission adopted the requirement that financial statements in annual reports must be exactly the same as those filed in the 10-K with the Commission. The other information required in the 10-K and the annual report must only be substantively the same.

Because we were requiring financial statements to be the same, we went through our own S-X requirements, especially our footnote requirements and made some revisions. We cut out some information that companies had been furnishing, and which apparently was not being used. If you follow annual reports or financial statements in 10-K's in the U.S., you will have seen in some reports a stock option note which varies from half a page long to two pages. This originally came about because stock options, although they have value, are not accounted for, i.e., measured, in financial statements. We have now dropped that, not only from the financial statements in

annual reports but from the financial statements of the 10-K as well. We reviewed the other footnote requirements and made some changes and some deletions. We believe that the set of financial statements which is presently required will give sufficient information to shareholders and by having only one set of financial statements for annual reports, 10-K's and '33 Act filings, we will have simplified the rules and have reduced the reporting burdens on registrants.

There are still problems to be resolved however. Parent company financial statements, which are required in 10-K's under some circumstances, are not generally furnished in reports to shareholders in the U.S. The same is true for subsidiary's financial statements, both consolidated subsidiaries where they have a special kind of relationship such as an insurance company or a bank where they are a regulated subsidiary or unconsolidated subsidiaries which if they are material, are required to be furnished in financial statements in 10-K's. That information is still required in the 10-K. For the time being, we have permitted companies to not put these financial statements in their annual reports to shareholders. Technically we have done this by changing their status to schedules in the 10-K, and we are now, and will be over the next six months, looking at that information which is furnished in separate financial statements of parents and subsidiaries to determine how much of that is really essential

to shareholders and whether or not greater detail is necessary in the reports filed with the Commission. So that is a problem that we have not quite solved and will be working on.

We also changed the requirements for interim financial statements. If you are familiar with the '33 Act filing requirements you know that there are certain timing questions which govern what financial statements must be furnished in a '33 Act statement. When companies file long after their fiscal year they have to update their financial statements in some cases, but our 10-Q's, which is our quarterly report, require only condensed financial statements and are not in the same detail. We have now changed all of the requirements so that any time you have an interim statement, it will only have the amount of detail required in the 10-Q.

The Commission has deleted the requirement that companies provide a five year summary of operations in the annual report as well as in the 10-K. We have also increased some requirements. Three years of financial statements are now required as opposed to the old requirement of two years. This is consistent with the '33 Act which requires three years financial statements. In place of the summary of earnings we have now required something called selected financial data. This is narrower in that it does not have all the information previously in the summary of earnings but is

broader in that we also require other kinds of information to be presented, such as total assets and long term liabilities. We have done that in the feeling that the five year data which is presented should be presented for the purpose of showing trends as opposed to the detailed information in the shorter three years of financial statements. We have also given leeway to filing companies to present other information. We picked certain information which must be furnished -- sales, assets, long term liabilities, but we have a general requirement that if there are other kinds of information which would impact on an analyst in terms of the company's trends that they should also include that information.

I don't know how many of you follow the requirements for a management's discussion and analysis - I'm sure some of you do; however, others may not. When we first adopted this requirement, the initial proposal was to simply require that management discuss its results of operations and talk about significant matters without prescribing any detail. Believe it or not, we got great comment and complaint, as the companies wanted to be told exactly what we wanted. They did not want the freedom to make their own minds up about what to tell their shareholders. We believe that reflected lawyers' fears of liability. So, unfortunately, from my view anyway, the Commission adopted some very specific

requirements and provided us some examples of numerical relationships which would normally be commented upon. It wasn't a strict requirement, they said these are examples of some of the things you might want to talk about in the management's discussion. Unfortunately, most companies simply picked up on those numerical tests. If sales were up more than 10%, they felt they had to talk about it and write down the line for each item in the income statement. So much so that there were very few of what I would call really useful management discussions. It was very disappointing to me personally, particularly because I felt that this was an opportunity for companies to tell their own story in a Commission filing. It should have been a step away from the Commission's very stringent requirement in terms of not permitting a company to say very much about future trends or about its values and assets and that sort of thing. We got very little response.

Everybody has recognized that and, as a result, the present requirement is broader. It focuses not only on results of operation, but also on financial condition, capital resources and on liquidity of the corporation. There are no specific requirements that management must talk about. It is up to them to make their own minds up about what is important about what has happened to their company during the last few years in terms of its liquidity, in terms of its capital resources and its opera-

tions, and decide for themself what to talk about. We totally did away with the numerical tests, so companies will no longer be able to rely on just commenting upon certain things which they think they can see in the rules. I am very hopeful that we will get some good discussions from corporations under this change.

We do not require any forward looking data in a specific sense. The Commission over the past five or six years has looked at the question of projections and forecasts, and considered requiring it because it believes investors are very interested in that data. But we have found a very great reluctance on the part of the US companies to get into this area. Again, we believe it is in large part because of what they perceive as potential liabilities if they don't happen to meet their projections. Although the new rules encourage but do not require disclosure of forward-looking information, they do require disclosure of presently known information which will impact on future operating results. For instance, if you have a major contract which you know is not going to be renewed and therefore will affect next year's operation, perhaps you need to talk about it; and, if you have a major new contract that you have not had in the past, you would probably need to talk about it.

Those are the highlights of the proposals which were adopted. Let me spend just a few minutes on some new proposals in terms

of '33 Act filings. We are proposing new filing forms, and have even changed the designation. The old forms were called S-1, S-2, S-7 etc.; the new forms, at least in the proposal, have been termed forms A, B and C to show a clear demarcation, but the requirements of these forms as proposed are very significant, I believe. Form A would be a form used by a company whose stock is traded actively in the securities markets and whose financial information is pretty well absorbed by people who are buying and selling in the market. If we go forward with this form, a company who is in that position could have a securities offering with a prospectus of 2 to 4 pages, which would contain no financial statements or information. The information would be incorporated by reference from the 10-K's in order to put them technically under the '33 Act requirements. No distribution of financial information would be required on the assumption that the market fully understands the company and that its price is set properly because of that full understanding. In concept, that form could be filed Tuesday and you could sell on Thursday. It could possibly even be done from Tuesday to Wednesday and would not take the usual 2, 3, or 4 week period that even a good company sometimes goes through to get an effective prospectus. I believe that is a very great change.

The second level of reporting of propsectus information for companies would be Form B. This area would include a company which is not traded quite as actively and therefore we feel that some distribution of financial and other information is necessary for the offering. Hopefully, it could be done by merely including a copy of the annual report to shareholders, together with a short prospectus. That would mean that the description of business, segment information, and management's discussion and analysis might not be the same as that contained in the 10-K report but would be that contained in the annual report to shareholders. Therefore, you would not have to go through a whole new preparation of documents to sell securities, that would be for the next level of companies, companies not trading quite as actively. Those companies do not have the same kind of information distribution as those which are trading very actively.

The third level of reporting would be about the same as we now have in our existing S-1, our general registration statement requirement. This would be for new companies and for companies in financial difficulty. One of our problems in that area, and we are going to have to get comments from the public to determine final criteria if this works, is how do you determine when a company is in financial difficulty. When do you go from Form B to Form C? That is going to be

a very sticky wicket, and we have put out some suggested criteria for comment. We do not have any strong confidence that they will be the criteria we shall ultimately use, and we will need signficant comment on that from the public.

I want to call your attention specifically to the request for comments in this area from foreign companies. Most of what I have talked about here will be applicable to domestic companies. It would also be applicable to foreign companies which file under Form 10-K and thus meet the same information requirements as domestic companies, but the only companies that are required to do that now are Canadian companies and Mexican companies, i.e. North American companies. We are looking for ways for foreign companies to be eligible for the same kind of programme, if criteria can be worked out so that it would qualify, but as you recognize from what I have said, you need to have a situation where the foreign company's financial information is sufficiently available in U.S. markets so that it would not have to be separately distributed at the time of a proposed offer. Those of you who are in the U.S. markets should take advantage of this opportunity to give us whatever ideas you have, as to how this can be developed for foreign companies.

I was told by my people in the Division of Corporation Finance that each company which is presently filing with the Commission

will get, or should have gotten, a copy of these proposals. If you have not gotten those, you should write to us and get a copy of our proposals on forms A, B, and C so that you can take advantage of the opportunity to give us comments and, to put it the other way, you can help us reach decisions in this area by giving us your comments on what we are trying to do.

Obviously, I have only covered the very broad comments and changes in the forms. I have tried to cover the most important ones. I will close by giving you my own views as to some of the things we will see in future annual reports.

Number one, I think, as I heard someone here yesterday say we will have an emphasis on forward looking data in the annual report. The trend today, I believe, is much more towards relevant data; information which is of greater value to shareholders, although perhaps not as reliable in the objective sense as that which we have been furnishing in the past. For a long, long time the Commission was a bottleneck in that kind of data being furnished because we would not permit it to be included in our filings. During the last ten years that has begun to be changed. The present Commission, I think, is ready to accept that kind of data or even to require it if we could get support from the business community. As someone

said yesterday, you can only really require what people are willing to give you and, to some extent, that is always true. I believe one of the reasons why the Commission has not adopted a requirement for forecasts or projections is that it believes that it will have more success by urging voluntary disclosure of forward-looking information than by trying to make specific requirements. So, I see an emphasis on the forward looking data and I see, in particular, emphasis on more relevant data.

In the oil and gas area, as most of you already undoubtedly know, we have proposed to require value oriented information in the financial statements which are filed with us. We have not made any decision on that, but I believe that ultimately that kind of value oriented information in oil and gas reserves will be required in Commission filings, even if not in the basic financial statements, and I think that other information about values will be finding its way into financial reporting in the United States, hopefully through the medium of the FASB as it looks at issues in this area.

The only other thing I want to talk about is the information overload and readibility question. I heard yesterday a suggestion that shareholders who do not really want complete financial statements could be given less in an annual report to shareholders. The Commission has no present proposals

in this area, but we are aware -- and I use the broad 'we' here advisedly because I think it is true generally - of the growing length of annual reports to shareholders and of the comment that most shareholders do not really want that much material. We are at least going to look at that question as we go into the future and see if it makes any sense to have a shorter report which will be sent to all shareholders along with the availability of the rest of the more detailed information which is presently furnished in financial statements and/or in the 10-K. There will still be some detailed information in the 10-K which is not included in annual reports to shareholders and that whole question is one which we will be continuing to study as we go into the future.

That covers the highlights of what the Commission has done, and I hope some of the things that we have seen in annual reports. I am open to you for questions either now or, in view of the hour, perhaps this afternoon.