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COMMUNICATION OF CORPORATE INFORMATION: AN UPDATE

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I am pleased to have the opportunity to address the National Investors Relations Institute, an organization whose main objective is meaningful communication with corporate shareholders, an objective shared by the Commission. In March, I addressed a joint conference of the Chicago chapters of the Financial Executives Institute and this group concerning the communication of corporate information. I indicated then that this area is ripe for improvement through the combined efforts of the corporate community, the accounting profession and the Commission.

Today, I want to reemphasize and expand some of my thoughts in this important area and to outline some of the Commission's efforts to improve the corporate communications process. In particular, I want to briefly describe the Division of Corporation Finance's planned reorganization and some of its recent projects, as well as some of the ways in which the private sector can participate.

First, allow me to briefly reiterate the theme of my March talk, which is that the obligation for an integrated system of full and fair disclosure rests on the individual company. It is the company that knows what information about it is important. The Commission's disclosure requirements are of general applicability and cannot address

the specifics of individual companies. Companies cannot satisfy their obligation of providing investors with useful and pertinent information by legalistic and mechanical adherence or compliance with Commission disclosure requirements. Such responses only encourage or provoke the Commission, in an effort to discharge its responsibilities and to overcome a failure of meaningful disclosure, to become increasingly specific and prescriptive in its requirements. The cycle threatens to become one of increasingly specific disclosure requirements being applied to all companies, with varying degrees of relevancy, and legalistic corporate response. We must break the cycle.

The corporate communication process also has become somewhat fragmented and should be more cohesive. In this respect, many view the Commission's disclosure system as one primarily between reporting companies and the Commission. I do not agree with that assessment. We must bear in mind that the intended beneficiaries of the process are investors and the financial community. It is imperative that the required forms and reports be useful to the investor -- whether an individual or a professional analyst. To assure achieving this objective requires the joint efforts of companies, the financial community, the accounting profession, the bar and the Commission.

While the Commission may have been, with the best intentions, overly restrictive in its rulemaking in certain areas, the corporate community has not always been fully cooperative in developing a meaningful information flow to shareholders and investors. In fact, many of the Commission's past actions have been responsive to developments, and perceived weaknesses, in the informal communications arena. These informal shareholder communications, which are outside the realm of required filings, have significantly increased. To some extent this increase has been beneficial, but in many instances, glossy annual reports and overly positive press releases have painted less than a full, fair corporate picture. This is unfortunate testimony to what can be an important and effective communication medium. In my view, public confidence in corporations directly relates to their willingness to be forthright in their formal and informal communications. And, insofar as the Commission's regulations are an impediment to the free flow of information, they must be reexamined. In the same light, companies must reconsider

any of their policies or practices that are detrimental to the transmission of useful information.

The goal of providing investors with more useful and pertinent information will be realized only if companies accept the primary responsibility for providing disclosure, and if given flexibility by the Commission, discharge it in a substantive fashion. This afternoon, I want to describe the Commission's role in facilitating that goal.

REORGANIZATION OF THE DIVISION OF CORPORATION FINANCE

In order to assist companies in meeting their responsibility, the Division of Corporation Finance has initiated a reorganization of its Operations Unit. As all of you know, the Commission's Division of Corporation Finance is charged with setting the policy for, and then reviewing, virtually all the filings made with the Commission pursuant to the Securities Act of 1933, which generally pertains to the initial issuance of securities, and the Securities Exchange Act of 1934, which generally pertains to subsequent periodic and other disclosures which must be made by companies once they have issued securities.

The Commission is pursuing a policy of integration of the 1933 and 1934 Acts. This policy grew out of a recognition that the large reservoir of continuously updated information accumulated under the 1934 Act might be used in partial or total substitution for the sporadic, and often duplicative disclosure provided in registration statements under the 1933 Act. The integration of the securities acts not only provides a more coherent regulatory structure, but also redounds to the benefit of companies. As the Advisory Committee on Corporate Disclosure noted:

> A continuous, coordinated, and integrated disclosure system for industrial issuers required to file information under the 1933 and 1934 Acts will curtail registration costs and administrative obstacles incurred by industrial issuers in raising capital, facilitate timely access to the capital markets, and simplify the exchange offer and business combination process.

The Commission took an initial step toward a closer integration of the two Acts as far back as 1967 in adopting Form S-7. More recently, as a first step in a concerted program, the Commission has adopted, and then expanded, the short-form registration statement Form S-16.

In addition to this accelerated movement toward integration, there have been other major changes in recent years affecting the Division of Corporation Finance's work. First, the number of filings has increased significantly. Second,

the complexity of corporate financial transactions and relationships has grown. Third, communication and data analyzing technology has exploded. Finally, empirical knowledge concerning the financial markets has expanded, coupled with the emergence of such concepts as the efficient market hypothesis, the capital asset pricing model, and various methods of discounted cash flow analysis and risk modeling.

These changes dictate that the Division organize itself differently. As a result of increased filing volume and complexity, coupled with a reduction in staff size, not all filings can be reviewed. With respect to some filings, the Division will shift to an "audit mode," in which screening and selection techniques will be used in allocating staff time. Key filings such as initial registrations on Form S-1 will all, of course, be fully reviewed. But, to reduce other reviews, the Division is, for example, considering a proposed rule under which pre-effective review for employee stock plans on Form S-8 will be discontinued. The major result of this approach will be to free operations resources for concentration upon the full review of both 1933 and 1934 Act filings which have been identified as critical, and, the assessment of, and response to, the need for

change in the disclosure rules. A current example in this regard is a forthcoming proposal designed to significantly reduce and standardize the exhibits required in filings.

Another major element in the Division's reorganization is the restructuring of the operations side of the Division. This will be done by consolidating the personnel in the existing 15 branches into ten larger branches, two under each of the five Assistant Directors. The increase in the size of each branch and the switch to the "audit mode" as a general review approach will free some branch personnel to work on task forces set up to address specific problems. One example is the Form 10-K task force which is addressing ways to simplify the 10-K annual report and to adapt its parts for incorporation by reference in other forms. Another task force is addressing the generic issue presented by integration of the two of how best to shift the emphasis from review of 1933 Act filings to review of 1934 Act filings, so that the stream of 1934 Act reports can become the reliable backbone of all required disclosure.

Also of importance is the proposed change in the way in which filing companies are assigned to branches. Not only will there be a reduction in the number of branches, but over the course of the coming year or so, all

registrants will be assigned to one of 34 industry groups, with roughly seven groups per Assistant Director. This will permit the Division to focus on the particular needs and characteristics of entire industries, thereby increasing its ability to assist registrants and better respond to the uniqueness of specific industries.

In addition, the Division is adding a new office in its Operations Unit to oversee the training and consistency of work among the line branches. This Office will help to identify and respond to the need for rule changes and to avoid inconsistent or nit-picking comments on filings.

The operations section of the Division also has embarked on an effort which, gradually, should result in the enhanced availability of filings, in genuinely useful form, to the public. Current efforts include contracts with a private company designed to produce for public use microfiche copies of filings and time-shared computer access to copies of filings. Similarly, the operations section is engaged in an effort to better utilize modern data processing technology. One initial planned phase of this effort is enhancement of the automated identification of late or omitted filings.

OTHER COMMISSION INITIATIVES

I would now like to turn to some of the specific projects the Commission has undertaken to enhance the communication of relevant corporate information. However, before doing so, I want to discuss one theme which is ever present in examining the problem of adequate corporate communications -- the tension between the corporate desire for free form expression, in terms of both substance and format, which is generally available in the informal communications network, and the perceived need for minimum disclosure standards, which is generally provided by Commission disclosure requirements. To express this tension in another way -- there is need to strike a balance between minutely detailed, inflexible checklist disclosure requirements and readable non-substantive prose.

Minimum Disclosure Standards v. Free Form Communications

Perhaps the most troublesome aspect of minimum standards of disclosure is that too often minimum requirements become maximum disclosure. In many instances, this is a reflection of the all too prevalent, but understandable, philosophy of limiting compliance to legal requirements as contrasted to fulfilling the corporation's obligation to inform investors. Mechanical application of minimum standards is substituted for meaningful corporate dialogue.

What appeared at one time to have the potential of becoming useful disclosure becomes boilerplate. And, the regulator's typical response is to become more precise and more prescriptive in its requirements, which prompts a negative and further legalistic response from companies.

Let me illustrate this problem. As I have observed on other occasions, "Management's Discussion and Analysis," which accompanies operating summaries, is vital to the usefulness of reported financial information. It calls for management to explain and interpret its operating results. Recognizing that financial reports are only a form of mathematical abstraction of historical events that are often not self-explanatory, cannot always be quantified and many times are not predictive of future events, the intent of the existing guides dealing with "Management's Discussion and Analysis" is for management to discuss the more important changes in operating results, together with an explanation of the causes of those changes and an assessment of trends or other data which may make reported historical figures not indicative of current or future operations.

Unfortunately, "Management's Discussion and Analysis of Operations," is, all too commonly, not producing meaningful and relevant disclosure. Far too many companies are

addressing only the simplistic and obvious -- sales were up X percent and operating expenses up Y percent -- the kind of analysis that would not do credit to a first year business student. It is the reasoning and analysis of the factors behind the numbers that is important; and, regrettably, it is these very elements that are lacking in most filings.

In the search for safety and certainty, boilerplate has replaced substance. The blame, however, does not rest solely with the private sector. The Commission must share the responsibility for disclosure requirements which result in boilerplate, but companies must realize that they cannot satisfy their disclosure obligations simply by viewing the Commission's disclosure requirements as a checklist.

A solution, which at first blush seems attractive, would be to allow full latitude to companies in composing their disclosure documents, in terms of both substance and format. However, I am satisfied that some minimum content standards are necessary for all communications, whether formal or informal, to assure that important information -- both favorable and unfavorable -- is adequately and timely communicated to the marketplace. As the Advisory Committee on Corporate Disclosure noted:

> Although the Commission's Forms 10-K and 10-Q are intended to communicate basically the same information as the company's reports to shareholders, there often are significant differences between them. In general, the writing style in shareholder reports is more readable than that in 10-K's and 10-Q's. On the other hand, the information filed with the Commission frequently is more complete.

Minimum standards are also needed to permit meaningful comparisons of companies in the same or similar industries. The objective, however, should be to achieve the necessary disclosure without impinging on the level of communication achieved, for example, in the annual report to shareholders -- and to make reports more useful without sacrificing content.

Let me now turn to some specific projects we have undertaken which are illustrative of some of the tensions discussed above.

Projections

Perhaps the best example of an attempt to improve corporate communication has recently been accomplished. The recent change in the Commission's policy to one of encouraging forward looking information, coupled with the adoption of a safe-harbor rule, is designed to enhance meaningful corporate disclosure. I would hope that registrants will avail themselves of this opportunity to provide investors with much desired, and much relied upon,

information on a publicly disclosed basis so that the practice of selective informal communications of projections may be replaced.

When the Commission began to explore encouraging disclosure of forward-looking information, it did so with some trepidation. However, the safe harbor rule is an indication of the Commission's desire to encourage the private sector and to cooperate in a combined effort to create a more effective disclosure system.

Form 10-K Project

Another project the Commission has undertaken in order to provide more relevant and meaningful disclosure is an extensive review of Form 10-K. Our project is predicated on the belief that the Form 10-K is, as the Advisory Committee suggested, the critical document in the integration of the 1933 and 1934 Acts. Accordingly, it is essential that the disclosure in the 10-K be improved so as to facilitate integration. In this respect, it has been our experience that while filings under the 1933 Act are of consistently good quality, 1934 Act reports do not always meet the same high informational standards. Perhaps this is due to the relative lack of emphasis placed on 1934 Act filings over time by management and the Commission alike.

In order to arrive at integration of the Acts, both the Commission and the private sector must alter their priorities. For our part, in addition to ongoing analysis of the disclosure items, we intend to place greater emphasis on review of 1934 Act reports. I would urge that the private sector take similar steps in complying with its obligations under the 1934 Act. Indeed, I believe that boards of directors should exercise greater oversight over 1934 Act disclosure. In my opinion, it is desirable that a draft of the Form 10-K be circulated among the members of the board prior to Commission filing. As the Form 10-K becomes the critical document in the disclosure process, boards of directors must assume commensurate responsibility.

I expect that a proposal for to a new Form 10-K will be presented for public comment before year end. For many of the reasons I spoke about earlier, we do not propose to adopt a totally free form document. The main thrust of the efforts with respect to the 10-K is to identify and delete the duplicative, outmoded and sometimes costly requirements present in the existing form. To the extent possible, those provisions which encourage legalese and boilerplate will be revised to create

a more substantive and readable -- and therefore hopefully a more read -- report.

Perhaps the most important aspect of the Form 10-K project is the consideration of revisions to the financial statement requirements. Foremost is the establishment of one standard set of financial statements for inclusion in the more common forms filed with the Commission. Historical statements covering a uniform number of years would be required. As you are no doubt aware, the different requirements in the various forms have caused confusion on the part of companies, as well as investors. Some flexibility is expected to be built into the new requirements so that a company can seek relief if certain rules are inappropriate or unduly burdensome in a particular case.

As an integral part of the financial statement study, the staff is in the process of a comprehensive review of the Commission's financial requirements for commercial and industrial companies set forth in Regulation S-X. The last comprehensive review of Regulation S-X was completed almost seven years ago. Since then, the old Accounting Principles Board issued seven opinions and its successor, the Financial Accounting Standards Board, published

33 statements and 30 interpretations. As a result of these efforts, many of the disclosure requirements in S-X are duplicative of GAAP. The comprehensive review will reconcile and eliminate any unnecessary duplication. To the extent that minimal differences may continue, some effort at further reconciliation may be implemented by requiring the inclusion of the S-X disclosure standards in annual reports to shareholders under the Commission's proxy rules.

PRIVATE SECTOR RESPONSIBILITY

I have devoted most of my talk this afternoon to actions the Commission is taking to assist registrants in meeting their responsibility to provide full and fair disclosure to investors. I would like now to mention briefly some actions the private sector can take to facilitate the process of corporate communication in addition to fulfilling your basic responsibilities.

As I stated earlier, companies have the basic responsibility to assure and improve their credibility with investors and other users of corporate information. Responsible management will provide information that responds to the spirit and the purposes of the disclosure

requirements and should be encouraged to do so. Efforts, such as NIRI's to report to its members examples of what it considers to be particularly thoughtful disclosures is very helpful, such as in its recent publication which mentioned proxy statement disclosure concerning boards of directors.

Organizations, such as NIRI, can also assist in improving the corporate communications process by commenting on Commission rule proposals. In that vein, I was especially disappointed that NIRI did not comment on the Commission's recent proposals for changes in the proxy rules. Members of NIRI are in a particularly good position to comment on the effectiveness of shareholder communication via proxy statements, as well as in substantive areas, such as management remuneration and the 10-K project.

Efforts should also be undertaken to expand the availability of proxy statements. Proxy statements contain unique information (not easily available elsewhere) that can be quite useful, and they generally do not get as wide a distribution as other corporate publications, particularly to analysts and potential investors.

In addition, there are specific areas of disclosure which call for significant improvements. In my March talk I cited several of these areas, including earnings

announcements, disclosure of pension liability, and reporting on the impact of inflation and changing prices. I am pleased that significant progress has been made in these three important areas.

First, the Financial Accounting Standards Board (the "FASB") has issued a discussion memorandum dealing with the issue of the presentation of information about earnings. The project focus on the quality of earnings as opposed to excessive emphasis on a single net earnings number (the "bottom line") is encouraging. I would urge NIRI members to use this opportunity to take part in the FASB's deliberations and to focus on this very vital distinction and its impact on information contained in earnings announcements.

I also noted in March that disclosure of pension liability was inadequate. The FASB has since issued a exposure draft on the subject, but there is no reason that companies should not voluntarily provide more adequate disclosure now.

Finally, in what I consider to be an extremely significant event, the FASB has issued a statement, Number 33, establishing standards for reporting the effects of inflation and changing prices. In my view, the failure

of corporate reporting to provide adequate information about the impact of inflation and changing prices on corporate performance was the most serious deficiency in corporate disclosure. FAS Number 33 provides the opportunity for corporate managements to describe, in laymen's language, the effects of inflation on their earnings. In fact, the Statement requires companies to provide, in their financial reports, explanations of the mandated information disclosures of the Statement and discussions of its significance in the circumstances of the company. I urge companies to respond to this unique opportunity substantively, particularly in their Management's Discussion and Analysis, to discuss real corporate profitability and to demonstrate the need for more investment and changes in tax policy. Individual corporations, in their desire to show growth in earnings and performance of management, have communicated a distored picture, out of focus with the economic reality of corporate earnings. This has contributed greatly to a public and political sense that corporate profits are greater than they are and indeed "excessive" and "obscene." If corporate managements choose not to make the case for corporate profits in their own communications on the subject, then

they have no one to blame but themselves for the political consequences. I urge you to seize the opportunity to communicate the significance of inflation on corporate performance.

CONCLUSION

This afternoon, I have reiterated the basic theme that is played over and over in the quest for a meaningful disclosure system -- true cooperation between the government and the private sector -- simplification of mandated requirements -- and, wherever possible, greater reliance on the private initiatives of individual companies.

We at the Commission are determined to provide for communication of relevant, accurate and timely information to the marketplace. It is only through cooperative effort that we can strike the appropriate balance between private sector initiative and Commission action in this important area.

Thank you.