

Disclosure Committee Best Practices



DISCLOSURE COMMITTEE BEST PRACTICES

In light of the SEC rules requiring reporting companies to maintain “disclosure controls and procedures,” the need for such companies to form and maintain a disclosure committee has increased and the role of such disclosure committees has become more significant. Disclosure committees are called upon to assist the chief executive officer and chief financial officer and the audit committee in preparing the disclosures required under the SEC rules and to help ensure that a company’s disclosure controls and procedures are properly implemented.

At Foley’s sixth annual National Directors Institute on March 8, 2007 in Chicago, a panel discussion on “Disclosure Committee Best Practices” was moderated by Patrick Daugherty, partner, Foley & Lardner LLP, and included Jeffrey Brown, senior corporate counsel, Motorola, Inc., and Luis Machado, associate general counsel, corporate and assistant secretary, William Wrigley Jr. Company. Mr. Brown and Mr. Machado are members of their respective companies’ disclosure committees and the panel discussed the organization and composition of disclosure committees, the manner in which disclosure committees carry out their work, and the appropriate role for, and the relationship between, insiders and outsiders with respect to the work performed by disclosure committees.

Statutory and Regulatory Basis for Disclosure Committees

Even though we have seen an increase in the number of companies that have established a disclosure committee since the adoption of the Sarbanes-Oxley Act (SOX) and the SEC’s rules implementing the various requirements of SOX, there is currently no legal obligation for any company to maintain a disclosure committee. The SEC has merely recommended that each reporting company establish such a committee to consider the materiality of certain information and to determine such company’s disclosure obligations on a timely basis.

Even though disclosure committees themselves are not legally required, the work they perform is the result of SEC regulations requiring each reporting company to maintain disclosure controls and procedures and the CEO and CFO of each reporting company to make certain certifications with respect to such disclosure controls and procedures in the periodic reports filed with the SEC. The SEC requires reporting companies to maintain controls and procedures “designed to ensure that information required to be disclosed by [an] issuer in the reports that it files or submits under the [Exchange] Act is recorded, processed, summarized and reported within the time periods specified in the Commission’s rules and forms.” The purpose of disclosure controls and procedures is to make certain that the information required to be disclosed is “accumulated and communicated to the issuer’s management . . . to allow timely decisions regarding required disclosure.” In most cases, it is a company’s disclosure committee that has been charged with carrying out this requirement.

Composition and Organization of Disclosure Committees

Most disclosure committees are governed by a charter, which can vary dramatically in terms of scope and detail. Some charters merely establish the disclosure committee and set forth in broad strokes the requirement that the disclosure committee be responsible for collecting and evaluating information that may need to be disclosed in public filings.



Other charters specify the frequency of meetings, the process by which the disclosure committee is to collect information and the manner in which the disclosure committee is to present such information to the CEO, CFO and audit committee. One type of charter is not preferred over the other; rather, each company must determine for itself what is most appropriate.

Because the SEC has not adopted rules relating to disclosure committees, there are no specific requirements as to which officers or members of management must serve on disclosure committees. In noting their own experiences, the panelists indicated that while not every disclosure committee must be same, there are certain individuals who should be strongly considered to be members of a company's disclosure committee. Namely, the panelists suggested that members from a company's legal department, investor relations group, the accounting department and internal auditors are logical choices to serve on a disclosure committee. The panelists also noted that individuals knowledgeable about the company's primary or key business units are ideal members. For example, for retail companies, an executive officer overseeing merchandising would be an asset to the disclosure committee, or, for utility companies, an executive officer overseeing utility operations should be considered. It is important to note, however, that most disclosure committees are comprised of "seasoned professionals" rather than field-level managers, which helps to ensure that the members have an understanding of the "big picture" in terms of what information is truly material to the company as a whole, and, therefore, required to be disclosed.

There are differing lines of thought when it comes to having a formal chairperson preside over the disclosure committee. Some companies prefer to have a formal chairperson, with the chief legal officer or another executive level officer from the legal department filling such a position. In those instances, the chairperson is responsible for the administrative tasks of overseeing the disclosure committee, such as scheduling and conducting meetings. When there is no formal chairperson, the panelists noted that the attorneys on the disclosure committee often take a lead role in facilitating the discussions during the meetings.

Disclosure Committee Operations

From the varied experiences of the panel members, it is clear that the operation of a disclosure committee is not a "one size fits all" process. There are numerous ways in which a disclosure committee can carry out its function of evaluating information and assisting with the disclosure process. There are, however, several best practices that are intended to ensure that a disclosure committee operates efficiently.

Each of the panelists described how their respective disclosure committees operate on both a top-down and bottom-up approach. The top-down approach refers to information flowing from the disclosure committee to the heads of a company's various business units, corporate groups and subsidiaries. The disclosure committee, charged with evaluating information to determine whether it should be disclosed, must have an understanding of what type of information must be disclosed and what the relevant materiality thresholds are for determining whether certain information must be disclosed. Furthermore, the disclosure committee must be in tune at a macro level with respect to operations of the



company as a whole in order to determine which information is truly material and must be disclosed. Armed with such knowledge and understanding, the disclosure committee must educate those individuals responsible for each business unit, corporate group and subsidiary as to what type of information is relevant and of which issues such individuals should be aware. The disclosure committee must establish and carry out procedures for ensuring those company employees on the ground have an understanding of what must be disclosed, or, more specifically, what may need to be disclosed. There are a number of ways in which to ensure that this downstream process operates properly. In connection with the reports that disclosure committees receive from the field level executives, the disclosure committee will provide questionnaires with specific issues and matters to be considered. The committee can create a “tickler” system in which certain issues and matters are addressed at relevant times during the year. In addition to the questionnaires, the disclosure committee can identify specific issues that may be relevant for one particular business unit, corporate group or subsidiary that require further discussion or additional inquiry.

Just as important as the top-down approach, the bottom-up approach ensures that material information is raised to the level of the disclosure committee. It would be impossible for members of the committee on their own to be aware of every material event involving the company that may occur. Thus, it is necessary for a mechanism to be in place for information from the field to be brought to the attention of the disclosure committee. The bottom-up approach requires the heads of the different business units, corporate groups and subsidiaries to report information to the disclosure committee. For some committees, this means that the heads of these designated groups and subsidiaries deliver a written report to the disclosure committee. In other instances, rather than receiving a written report, presentations are made to the disclosure committee whereby follow up questions and discussions can ensure that all necessary information is vetted. The depth of the reporting-up process also varies. In some instances the reports are generated from one or two levels under the head of the particular business unit, corporate group or subsidiary, while in other instances the reporting can go six or seven levels deep in order to ensure that all necessary information is brought to the attention of the disclosure committee.

The length and frequency of disclosure committee meetings can also vary. Some committees meet over a two-day period, while others meet for a few hours. This is tied to whether the disclosure committee receives written reports or live presentations. Most disclosure committees meet at least quarterly as a full group, and often times the full committee will meet only quarterly and allow a subgroup to meet more frequently and on a more informal basis to discuss less material issues, such as matters to be disclosed in 8-K filings. In these cases, the subgroup is generally comprised solely of the attorneys on the committee, although there are some specific disclosure issues that are addressed by different members of the disclosure committee. One such example is Web site disclosures, which are often reviewed by the investor relations members. The key, the panelists stressed, is for the various members to realize their own areas of expertise and to take the lead when issues falling within such areas are brought before the disclosure committee.



The Appropriate Role for, and Relationship Between, Insiders and Outsiders

Insiders almost always comprise the entire disclosure committee. As noted above, disclosure committees often include individuals from a company's legal department, investor relations group, accounting department and internal auditors. The panelists noted that it may be inappropriate for the CEO or CFO to be a member of the disclosure committee. When such high level executives are on the panel, there may be an incentive on the part of lower level officers to sugarcoat information or use the disclosure mechanism as a marketing tool. This does not mean, however, that the CEO and CFO do not play an important role in the disclosure process. Because the bottom-up process is integral to effective disclosure procedures, it is essential that the appropriate individuals take the time and assert the effort necessary to make sure the process works. If the CEO and CFO stress the importance of disclosure procedures, then it is more likely that lower level officers will devote the time and energy required.

There is also a role for outsiders with respect to disclosure committees. Outside counsel and auditors offer guidance with respect to ever changing disclosure requirements. As previously mentioned, it is crucial that disclosure committee members have an understanding of what types of information must be disclosed. Outside counsel and auditors are often used to help educate committee members in this regard, and they also play a role when disputes arise between disclosure committee members. This does not mean that outside counsel must become involved in every discussion. Rather, the panelists noted, in those rare instances when the disclosure committee members cannot reach a conclusion with respect to whether certain information should be disclosed, they will often seek the advice of outside counsel.

In order to provide assistance to the disclosure committee, outside counsel and auditors may be invited to listen in on Committee meetings. The panelists stressed, however, that when involving outside auditors, certain confidential and privileged information should be guarded because "there is no such thing as auditor privilege." This means that, unlike information disclosed to an attorney, which is privileged, information disclosed to an auditor is not privileged, and may lose any privilege it once had and become discoverable if litigation were ever to ensue.

Conclusion

This panelists shares their own insights from their own experiences serving on disclosure committees, and they noted several "best practices" that may help other disclosure committees operate more efficiently and effectively. However, the panelists began their discussion with one main point – when it comes to the proper composition and operation of disclosure committee, there is no "one size" that fits all companies. The panelists repeatedly stressed that each company must determine what processes and procedures work best for that company.



For More Information

For more information on this session or the sixth annual National Directors Institute, visit Foley.com/ndi2007 or contact the panelists directly.

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