

**DAVIS POLK & WARDWELL**  
**Corporate Regulatory Report**

A Summary of  
Current Regulatory  
Developments Affecting  
Publicly Listed Companies

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## SEC Developments

### SEC Adopts Final Exec. Comp. Disclosure Rules

On July 26, 2006, the SEC adopted final rules to revise the requirements for disclosure of executive compensation in proxy statements, registration statements and other SEC filings. The new disclosure rules will apply to next year’s proxy statements for any issuer whose fiscal year ends after December 15, 2006. The new rules were adopted substantially as proposed with the exception of the elimination of the “Katie Couric” clause. This controversial clause (a requirement to disclose the compensation of up to three employees whose compensation exceeds that of the named executive officers) is being repropose for comment. In its new iteration, the requirement would apply only to large accelerated filers and will specifically exclude athletes, entertainers and other employees who have no policy making authority at the company or any of its major units. For a copy of the SEC’s press release on this development, see <http://www.sec.gov/news/press/2006/2006-123.htm>. For a copy of the DPW Newsflash on this development, [click here](#).

### SEC Issues Concept Release on SOX 404 Implementation; COSO Issues Guidance on Internal Control Framework

On July 11, 2006, the SEC published its Concept Release on Sarbanes-Oxley Section 404 (internal controls over financial reporting). This is part of a previously announced plan by the SEC to reevaluate Section 404 implementation in the face of growing concerns from companies over the cost and complexity of the internal control assessment process.

The SEC seeks comment on the following four areas of potential SEC and PCAOB guidance, and on whether guidance should be provided in other areas as well:

- » Identifying risks to financial statement account and disclosure accuracy and the related internal controls that address the risks, including how management might use company-level controls to address the risks.
- » Objectives of the evaluation procedures and methods or approaches available to management to gather evidence to support its assessment.

## *SEC Developments (cont.)*

- » Factors management should consider to determine the nature, timing and extent of its evaluation procedures.
- » Documentation requirements, including overall objectives of the documentation and factors that might influence documentation requirements.

For a copy of the SEC's press release regarding the issuance of the Concept Release, see <http://www.sec.gov/news/press/2006/2006-112.htm>. For a copy of the Concept Release itself, see <http://www.sec.gov/rules/concept/2006/34-54122.pdf>.

Also, COSO (Committee of Sponsoring Organizations of the Treadway Commission) has published further guidance on the internal controls process for smaller companies. Although targeted at smaller businesses, this guidance is also intended to help companies of all sizes understand and apply COSO's internal control framework. The SEC previously announced its intent to use this guidance as part of its reevaluation of Section 404 implementation.

For an executive summary of the COSO guidance, see <http://www.coso.org/publications.htm>. For a copy of the SEC statement regarding COSO's issuance of this guidance, see the press release at <http://www.sec.gov/news/press/2006/2006-114.htm>.

### **Conrad Hewitt To Be Next SEC Chief Accountant**

On July 24, 2006, the SEC announced that Conrad Hewitt will join the SEC as Chief Accountant beginning on August 18, 2006. According to the SEC, as Chief Accountant, Mr. Hewitt will oversee accounting interpretations, international accounting matters and professional practice issues. He will lead the Commission's work on implementing Sarbanes-Oxley's internal control provisions, reducing complexity in accounting, enforcing compliance with accounting standards, and promoting the convergence of accounting standards under U.S. GAAP and IFRS. Mr. Hewitt currently is Chairman of the Audit Committee of Varian, Inc. He also chairs the Audit Committee of North Bay Bancorp, and chairs both the Compensation Committees and the Audit Committees of S&P Co. and Pabst Brewing Co. From 1995 to 1998, he was California Superintendent of Banking and Commissioner of the California Department of Financial Institutions. From 1972 to 1995, Mr. Hewitt was the Managing Partner of Ernst & Young, and its predecessor firm, Ernst & Ernst, in the firm's Northern California (1986-95), Seattle (1979-86), and Honolulu (1972-79) regions.

For a copy of the SEC press release announcing Mr. Hewitt's appointment see <http://www.sec.gov/news/press/2006/2006-122.htm>.

## SEC Speaks

### Commissioner Atkins Discusses Corporate Governance and Stock Option Backdating Scandals

In a speech before the International Corporate Governance Network 11<sup>th</sup> Annual Conference on July 6, 2006, Commissioner Paul Atkins discussed his views on the regulation of corporate governance noting that he believes that a particular model of corporate governance should not be mandated because “share-owners are best placed to determine the governance model of their corporations.”

Commissioner Atkins also discussed the recent focus on stock option backdating noting that “it is worth taking a step back before we plunge headlong into wholesale condemnation of all options practices.” Commissioner Atkins went on to say that it is important to “distinguish scenarios that are black-and-white fraud from legitimate practices that are being attacked with attenuated theories of liability.” According to Commissioner Atkins, “there is no securities law issue if backdating results from an administrative, paper-work delay.” As an example, he cited cases where directors sign a unanimous consent and the signatures take a few days to trickle in. Here he noted that it is his view that “one could argue that the grant date is the date on which the last director signed, but this argument does not necessarily reflect standard corporate practice or the logistical practicalities of getting many geographically dispersed and busy, part-time people to sign a document. It also ignores that these actions reflect the true meeting of the minds of the directors, memorialized by executing a unanimous written consent.” Commissioner Atkins went on to say that care should be taken in the enforcement of compensation arrangements such as stock options so that these actions do not “undercut the business judgment rule” or “undermine a compensation arrangement that has served shareholders so well for many years.”

A copy of Commissioner Atkin’s speech is available at <http://www.sec.gov/news/speech/2006/spch070606psa.htm>.

## FASB Developments

### FASB Issues Interpretation of FAS 109, Accounting for Income Taxes

On July 13, 2006, the FASB issued Interpretation 48, *Accounting for Uncertainty in Income Taxes—An interpretation of FASB Statement No. 109*. According to the FASB, the Interpretation clarifies the way companies account for uncertainty in income taxes by prescribing a consistent recognition threshold and measurement attribute, as well as clear criteria for subsequently recognizing, derecognizing and measuring such tax positions for financial statement purposes. The Interpretation also requires expanded disclosure with respect to the uncertainty in income taxes. The Interpretation is effective for fiscal years beginning after December 15, 2006.

The FASB’s press release regarding the issuance of the Interpretation is available at <http://www.fasb.org/news/nr071306.shtml>. The Interpretation is available at <http://www.fasb.org/st/index.shtml>.

## Other Developments and DPW Memos

For a copy of the DPW memo on recent disclosures of potential violations of the Foreign Corrupt Practices Act, [click here](#).

For a copy of the DPW memo on the SEC enforcement proceeding against Raytheon related to its failure to provide meaningful MD&A disclosure of known negative trends and uncertainties at a subsidiary, [click here](#).

### Contacts

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