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Recent Developments in Corporate Governance and Disclosure Matters

The following is a summary of some recent developments relating to corporate governance and disclosure matters.

SEC Approves Revised Listing Standards Related to Compensation Committees and Advisors. On January 11, 2013, the U.S. Securities and Exchange Commission (SEC) approved the revised listing standards that the New York Stock Exchange and the Nasdaq Stock Market proposed as required by Exchange Act Section 10C(c)(2). Companies with listed securities will be required to satisfy the revised listing standards relating to the independence of compensation committee members by the earlier of their first annual meeting after January 15, 2014, or October 31, 2014. Companies will need to comply with the other new listing requirements by July 1, 2013. Certain companies, such as investment companies and controlled companies, will continue to be exempt from the listing standards related to compensation committees.

Additional information on the revised listed standards is available here.

New Iran-Related Disclosure Requirements Apply to Reports Required to Be Filed With the SEC After February 6, 2013. The provisions of the Iran Threat Reduction and Syria Human Rights Act of 2012 that require public companies to disclose information pertaining to certain Iran-related activities and transactions apply to periodic reports (Forms 10-K, 10-Q, 20-F and 40 F) required to be filed with the SEC after February 6, 2013. The SEC staff has confirmed its view that the new disclosure requirements apply to periodic reports that may be filed prior to February 6. Companies should review their activities and the activities of their affiliates to determine whether they have engaged in any specified activities or transactions involving Iran and whether disclosures will be required under the new requirements.

For additional information about these new provisions, please see our Planning for the 2013 Annual Meeting and Reporting Season client alert, available here.

Say-on-Pay Rules Now Apply to Smaller Reporting Companies. The temporary exemption from the say-on-pay rules afforded to smaller reporting companies (generally, those with a public float below $75 million) when the SEC adopted the rules in 2011 expired on January 21, 2013. Beginning with their first annual meeting (or special meeting in lieu of an annual meeting) occurring on or after January 21,

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2013, smaller reporting companies are required to conduct both a shareholder advisory vote on executive compensation and a shareholder advisory vote on the frequency of say-on-pay votes.

Smaller reporting companies will need to comply with the say-on-pay rules to the same extent as other companies subject to the SEC's proxy rules. In particular, smaller reporting companies must disclose in their proxy statements that they are providing say-on-pay and frequency votes and that such votes are nonbinding. Following the shareholder meeting, they must disclose their frequency determination either by amending the Form 8 K filed to report the annual meeting voting results, as required by Item 5.07, or by including the disclosure in a Form 10-Q or Form 10-K, provided the timing deadlines are otherwise satisfied. Additionally, in subsequent proxy statements, smaller reporting companies must disclose the current frequency of say-on-pay votes and indicate when the next say-on-pay vote will occur.

The applicability of the say-on-pay rules to smaller reporting companies does not change the scaled disclosure requirements of Item 402 of Regulation S-K. For example, smaller reporting companies are not required to provide a CD&A and thus need not disclose in subsequent proxy statements whether the company considered the results of the most recent say-on-pay vote in determining executive compensation policies and decisions. However, smaller reporting companies should determine whether the results of a say-on-pay vote formed a material factor necessary to an understanding of the information disclosed in the summary compensation table and thus should be disclosed pursuant to Item 402(o) of Regulation S-K. In addition, smaller reporting companies also should consider enhancing their compensation disclosure to facilitate shareholder understanding of their compensation arrangements and reduce the potential for an unfavorable say-on-pay vote.

Additional information concerning the say-on-pay rules is available here. A copy of the SEC adopting release for the say-on-pay rules is available here.

SEC Approves New PCAOB Auditing Standard Relating to Communications With Audit Committees. Last month, the SEC approved Public Company Accounting Oversight Board (PCAOB) Audit Standard No. 16 (AS 16). AS 16 applies to audits of all issuers, including audits of emerging growth companies (EGCs) and supersedes interim standards AU Sec. 80 and AU Sec. 310. The new standard will be effective for audits and quarterly reviews for fiscal years beginning on or after December 15, 2012. Thus, for calendar year companies, the new standard will apply to the auditor's review of financial statements for the first quarter of 2013 and to the engagement of the auditor for 2013.

AS 16 retains or enhances the communication requirements of the superseded standards and adds additional communication requirements. Among other things, AS 16 clarifies that auditors must establish an understanding of the terms of the audit engagement with the audit committee (rather than with management) and requires that this understanding be recorded in an engagement letter. The new standard also requires the auditor to communicate the following items, among others, to the audit committee in a timely manner and before the issuance of the audit report:

- an overview of the overall audit strategy, including timing of the audit, significant risks the auditor identified, and significant changes to the planned audit strategy or identified risks;
- information about the nature and extent of specialized skill or knowledge needed in the audit, and the extent of the planned use of internal auditors, company personnel or other third parties and other independent public accounting firms or other persons not employed by the auditor that are involved in the audit;

- certain matters regarding the company's accounting policies, practices and estimates (consistent with Rule 2-07 of Regulation S-X);
- information related to significant unusual transactions, including the business rationale for such transactions;
- the auditor's evaluation of the quality of the company's financial reporting;
- difficult or contentious matters for which the auditor consulted outside the engagement team;
- the auditor's evaluation of going concern;
- uncorrected misstatements aggregated by the auditor that management has determined to be immaterial;
- nontrivial corrected misstatements that might not have been detected without the audit (including the implications of the same on internal control over financial reporting);
- expected departures from the auditor's standard report; and
- other matters arising from the audit that are significant to the oversight of the company's financial reporting process, including complaints or concerns regarding accounting or auditing matters that have come to the auditor's attention during the audit.

To address the new communications requirements, public companies should ensure that audit committee members are aware of the new standard and, to the extent necessary, consider updating their audit committee agendas, calendars and charters to reflect the new requirements.

For additional information on AS 16, please see the PCAOB release adopting AS 16, available here, and the SEC release granting approval of AS 16, available here.

SEC Staff Considering Disclosure of Political Activity Spending. The SEC indicated in its most recently published semiannual regulatory agenda that the SEC staff is considering whether to recommend that the SEC issue a proposed rule to require that public companies provide disclosure to their shareholders regarding the use of corporate resources for political activities. In August 2011, the SEC received a petition to adopt a rule that would require such disclosure. To date, the SEC has received over 322,000 comment letters regarding the petition. Although SEC officials have previously disclosed that they were considering whether to recommend that the SEC issue a proposed rule requiring political activity disclosure, this issue had not previously appeared on the SEC's regulatory agenda. Future action by the SEC on this issue could come as early as April 2013.

Additional information about the potential rulemaking is available here.

Wave of Litigation Alleges Breach of Fiduciary Duties in Connection With Compensation-Related Decisions. In the wake of the federal rules and requirements related to executive compensation, there has been a recent wave of lawsuits alleging deficient disclosure with respect to compensation-related proxy proposals and seeking to enjoin the company's annual meeting until supplemental disclosures are made. Such lawsuits primarily target advisory votes on executive compensation (say-on-pay) and proposals to increase the amount of shares reserved for equity compensation plans, though there also have been a number of suits relating to proposals to increase the total number of authorized shares. The plaintiffs'

demands for additional disclosures are not based on allegations of deficient disclosure under SEC rules, but rather on the theory that a director may breach his or her state-law fiduciary duties by failing to disclose material information in connection with a request for shareholder action. Plaintiffs claim that a considerable amount of additional information is necessary for shareholders to make an informed vote.

Although no amount of disclosure will fully protect a company from these types of suits, companies should consider enhancing disclosures relating to say-on-pay votes, new or amended equity plans, and proposals to increase the total number of authorized shares.

For additional information, please see our Executive Compensation and Benefits Alert, available here.