Adoption of the Amendment

Accordingly, pursuant to the authority delegated to me by the Administrator, the Federal Aviation Administration amends part 39 of the Federal Aviation Regulations (14 CFR part 39) as follows:

PART 39—AIRWORTHINESS DIRECTIVES

1. The authority citation for part 39 continues to read as follows:

Authority: 49 U.S.C. 106(g), 40113, 44701.

§ 39.13 [Amended]

2. Section 39.13 is amended by adding the following new airworthiness directive:

98–16–12 Airbus Industrie: Amendment 39–10688. Docket 97–NM–148–AD.

Applicability: Model A320 and A321 series airplanes; as listed in Airbus Service Bulletin A320–28–1044, Revision 10, dated November 5, 1996; certificated in any category.

Note 1: This AD applies to each airplane identified in the preceding applicability provision, regardless of whether it has been modified, altered, or repaired in the area subject to the requirements of this AD. For airplanes that have been modified, altered, or repaired so that the performance of the requirements of this AD is affected, the owner/operator must request approval for an alternative method of compliance in accordance with paragraph (b) of this AD. The request should include an assessment of the effect of the modification, alteration, or repair on the unsafe condition addressed by this AD; and, if the unsafe condition has not been eliminated, the request should include specific proposed actions to address it.

Compliance: Required as indicated, unless accomplished previously.

To prevent blockage of fuel by the build-up of ice crystals, which could result in low fuel pressure, and consequent shutdown of the engine during critical phases of flight, accomplish the following:

(a) Within 24 months after the effective date of this AD, replace the mesh strainers of each fuel pump with improved strainers, in accordance with Airbus Service Bulletin A320–28–1044, Revision 11, dated August 26, 1997.

Note 2: Accomplishment of the replacement required by paragraph (a) of this AD in accordance with Airbus Service Bulletin A320–28–1044, Revision 09, dated June 14, 1996, or Revision 10, dated November 5, 1996, prior to the effective date of this AD, is acceptable for compliance with this paragraph.

(b) An alternative method of compliance or adjustment of the compliance time that provides an acceptable level of safety may be used if approved by the Manager, International Branch, ANM–116, FAA, Transport Airplane Directorate. Operators shall submit their requests through an appropriate FAA Principal Maintenance Inspector, who may add comments and then send it to the Manager, International Branch, ANM–116.

Note 3: Information concerning the existence of approved alternative methods of compliance with this AD, if any, may be obtained from the International Branch, ANM–116.

(c) Special flight permits may be issued in accordance with sections 21.197 and 21.199 of the Federal Aviation Regulations (14 CFR 21.197 and 21.199) to operate the airplane to a location where the requirements of this AD can be accomplished.

(d) The replacement shall be done in accordance with Airbus Service Bulletin A320–28–1044, Revision 11, dated August 26, 1997, which contains the following list of effective pages:

Page No.	Revision level shown on page	Date shown on page
1, 2, 5–8, 11, 12, 15–20.	Revision 11 ..	August 26, 1997.
4, 10, 13, 14	Revision 10 ..	November 05, 1996.
3, 9	Revision 09 ..	June 14, 1996.

This incorporation by reference was approved by the Director of the Federal Register in accordance with 5 U.S.C. 552(a) and 1 CFR part 51. Copies may be obtained from Airbus Industrie, 1 Rond Point Maurice Bellonte, 31707 Blagnac Cedex, France. Copies may be inspected at the FAA, Transport Airplane Directorate, 1601 Lind Avenue, SW., Renton, Washington; or at the Office of the Federal Register, 800 North Capitol Street, NW., suite 700, Washington, DC.

Note 4: The subject of this AD is addressed in French airworthiness directive 96–170–082 (B), dated August 28, 1996.

(e) This amendment becomes effective on September 8, 1998.

Issued in Renton, Washington, on July 27, 1998.

S.R. Miller,

Acting Manager, Transport Airplane Directorate, Aircraft Certification Service.

[FR Doc. 98–20676 Filed 8–3–98; 8:45 am]

BILLING CODE 4910–13–P

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 231, 241, 271, 276

[Release Nos. 33–7558; 34–40277; IA–1738; IC–23366; International Series Release No. 1149]

Statement of the Commission Regarding Disclosure of Year 2000 Issues and Consequences by Public Companies, Investment Advisers, Investment Companies, and Municipal Securities Issuers

AGENCY: Securities and Exchange Commission.

ACTION: Interpretation.

SUMMARY: The Securities and Exchange Commission (''we'' or ''the Commission'') is publishing guidance for public companies, investment advisers, investment companies, and municipal securities issuers regarding their disclosure obligations about Year 2000 issues. This release provides guidance to public companies so they can determine whether their Year 2000 issues are known material events, trends, or uncertainties that should be disclosed in the Management's Discussion and Analysis of Financial Condition and Results of Operations (''MD&A'') section of their disclosure documents. This release also sets forth our guidance regarding specific matters for companies to address in their MD&A Year 2000 disclosure. In addition, we address the need for companies to consider the Year 2000 issue in connection with other rules and regulations and when they prepare financial statements. Finally, we remind municipal securities issuers, as well as public companies, investment advisers, and investment companies, that the anti-fraud provisions of the federal securities laws apply to disclosure about the Year 2000 issue. This guidance supersedes the current staff guidance in revised Staff Legal Bulletin No. 5 (''Staff Legal Bulletin'').

EFFECTIVE DATE: August 4, 1998. For information regarding the first periodic reports filed by public companies that should follow this release's guidance, see Section I.A.

FOR FURTHER INFORMATION CONTACT: Broc Romanek or Joseph Babits, Office of Chief Counsel, Division of Corporation Finance at 202–942–2900 (with respect to public companies), Anthony Vertuno, Division of Investment Management, at 202–942–0591 (with respect to investment companies); Arthur Laby, Division of Investment Management, at 202–942–0716 (with respect to investment advisers), and Mary Simpkins, Office of Municipal Securities, at 202–942–7300 (with respect to municipal securities).

SUPPLEMENTARY INFORMATION:

I. Executive Summary

The ''Year 2000 problem'' arose because many existing computer programs use only the last two digits to refer to a year. Therefore, these computer programs do not properly recognize a year that begins with ''20'' instead of the familiar ''19.'' If not corrected, many computer applications could fail or create erroneous results. The extent of the potential impact of the Year 2000 problem is not yet known, and if not timely corrected, it could affect the global economy.

A. Public Companies [1]

Congress enacted the Securities Act of 1933 and the Securities Exchange Act of 1934 to provide for full and fair disclosure to investors.[2] Our disclosure framework requires companies to disclose material information that enables investors to make informed investment decisions. For public companies, our authority basically is directed towards eliciting disclosure.

Under this disclosure framework, all companies must provide specific categories of information. Companies have the flexibility, however, to tailor disclosure to their particular circumstances. In almost every case, we rely on this general framework and rarely provide specific guidance on any particular issue. Companies already disclose in their MD&A their assessment of known trends, demands, commitments, events or uncertainties that are likely to have a material impact.[3] MD&A is designed to allow investors to see the company through the eyes of management. Investors deserve no less with respect to management's assessment of their company's Year 2000 problems. To help companies with their disclosure obligations, we are providing specific guidance on what public companies should consider when disclosing information about their Year 2000 readiness.[4]

This follows similar actions taken by our staff. During the past year, the staff of the Divisions of Corporation Finance and Investment Management issued and then revised the Staff Legal Bulletin to provide specific guidance regarding Year 2000 disclosure obligations.[5] Both of the Divisions created task forces to determine the effectiveness of the guidance.

While the number of companies disclosing Year 2000 issues has increased dramatically, the task force surveys show that many companies are not providing the quality of disclosure that we believe investors expect. In response to continuing concerns regarding this important issue, we are providing more extensive guidance in this formal Commission interpretive release. This release supersedes the revised Staff Legal Bulletin.

Public companies should apply this interpretive guidance immediately after August 4, 1998. Companies with June 30th or July 31st fiscal year ends need to follow this guidance when they file their annual reports. Companies with quarter ends after the effective date of this release also need to follow this guidance.

We encourage companies with quarters that end on June 30th or July 31st to consider this guidance in their quarterly reports.

This release provides our guidance based on the current requirements of the federal securities laws. It briefly addresses a number of disclosure requirements, but focuses on MD&A. We address two important issues under MD&A—whether companies are required to provide Year 2000 disclosure and the type of Year 2000 disclosure that is required. As discussed in Section III.A below, we believe a company must provide Year 2000 disclosure if:

(1) Its assessment of its Year 2000 issues is not complete, or

(2) Management determines that the consequences of its Year 2000 issues would have a material effect on the company's business, results of operations, or financial condition, without taking into account the company's efforts to avoid those consequences.

We expect that for the vast majority of companies Year 2000 issues are likely to be material, and therefore disclosure would be required. When a company has a Year 2000 disclosure obligation, we believe that full and fair disclosure includes:

(1) The company's state of readiness;

(2) The costs to address the company's Year 2000 issues;

(3) The risks of the company's Year 2000 issues; and

(4) The company's contingency plans.

Each company also must consider if its own Year 2000 circumstances require MD&A disclosure of additional information. This release provides suggestions to help companies meet their disclosure obligations. In addition to MD&A, this release reminds companies that Year 2000 disclosure may be required in their financial statements and under other rules and regulations, as discussed in Sections III.B and C below.

B. Investment Advisers and Investment Companies

Because of the key role that investment advisers and the investment companies they manage play in the financial markets, we believe it is important for us to monitor the progress of these entities in preparing for the Year 2000, regardless of the materiality of any individual entity's Year 2000 issues. We believe that the best approach to monitoring the readiness of investment advisers and investment companies is to require that registered investment advisers provide detailed reports to us. In June 1998, we proposed a rule to implement this approach, as discussed in Section III.D below. Under the proposal, investment advisers would describe their Year 2000 preparedness, and that of any investment companies that they advise, in publicly available reports.

Investment advisers and investment companies that conclude that the Year 2000 issue is material to their operating results and/or financial condition would need not only to report to us but also to include disclosure in their public filings. Investment advisers and investment companies are reminded of their obligations under the anti-fraud provisions of the federal securities laws. These entities should follow the guidance provided in Section III.D.

C. Municipal Issuers

Municipal issuers also have disclosure obligations. Our regulatory authority over disclosure by issuers of municipal securities is not as broad as our authority over disclosure by public and investment companies. Generally, municipal securities offerings are, by statute, exempt from registration and municipal securities issuers are exempt from the reporting provisions of the federal securities laws, including line-item disclosure rules. Municipal securities issuers, and persons participating in the preparation of municipal securities issuers' disclosure, however, are subject to the anti-fraud provisions of the federal securities laws.[6]

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[1] As used in this release, ''public companies'' generally refers to corporate and similar issuers, rather than investment companies and investment advisers, which are addressed separately.

[2] The Securities Act of 1933 (''Securities Act'') can be found at 15 U.S.C. 77a *et seq*. The Securities Exchange Act of 1934 (''Exchange Act'') can be found at 15 U.S.C. 78a *et seq*.

[3] Item 303 of Regulations S–K (17 CFR 229.303) and S–B (17 CFR 228.303). The interpretive guidance in this release applies equally to companies that file forms under Regulation S–K and small businesses that file forms under Regulation S–B. Foreign private issuers should follow the guidance in this release, including MD&A disclosure called for by Item 9 of Form 20–F (17 CFR 249.220f).

[4] In 1988, we followed a similar approach when we specifically addressed the disclosure issue of illegal or unethical activities relating to government defense contract procurements. *See* Securities Act Rel. No. 6791 (August 1, 1988), 53 FR 29226 (August 3, 1988).

[5] The Staff Legal Bulletin was first issued on October 8, 1997 and revised on January 12, 1998.

[6] Section 17(a) of the Securities Act, 15 U.S.C. 77q(a); Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b); and Rule 10b–5 promulgated thereunder, 17 CFR 240.10b–5. *See* Statement of the Commission Regarding Disclosure Obligations of Municipal Securities Issuers and

Continued

Approximately 50,000 state and local governments have over $1.3 trillion in municipal securities outstanding.[7] Municipal securities issuers, like other organizations, have Year 2000 issues. Year 2000 problems may affect their operations, creditworthiness, and ability to make timely payment on their indebtedness. We encourage municipal securities issuers and persons who assist in preparing their disclosure documents to consider whether Year 2000 issues may be material to investors. If material, the disclosure documents used by municipal issuers should contain a discussion of Year 2000 issues to avoid misleading statements or omissions that could violate the anti-fraud provisions. In Section III.E, we provide guidance to municipal issuers, and persons assisting in the preparation of their disclosures, regarding Year 2000 disclosure.

II. Background

A. Significance of the Year 2000 Issue

As the end of this century nears, there is worldwide concern that Year 2000 technology problems may wreak havoc on global economies. No country, government, business, or person is immune from the potential far-reaching effects of Year 2000 problems. President Clinton recently stated that ''all told, the worldwide cost will run into the tens, perhaps the hundreds of billions of dollars, and that's the cost of fixing the problem, not the cost if something actually goes wrong.'' [8] Some estimates that include not only software and hardware costs, but also costs related to business interruptions, litigation, and liability, run in the hundreds of billions of dollars.[9]

Only one thing is certain about the impact of the Year 2000—it is difficult to predict with certainty what truly will happen after December 31, 1999.[10] To reduce the impact of this potentially serious, widespread problem, many public officials and private commentators have spoken out about the need to plan properly now.[11]

We intend to intensify our efforts to elicit meaningful disclosure from companies about their Year 2000 issues. Only through that disclosure can investors make informed investment decisions. We believe that companies have sufficient incentive to provide meaningful disclosure to investors and meet their Year 2000 disclosure obligations. These incentives include business reasons, investor relations concerns, and possible referrals to our Division of Enforcement.

B. Staff Efforts Regarding Year 2000 Disclosure: Divisions of Corporation Finance and Investment Management

The Year 2000 issues faced by the securities industry and ourselves are very serious. Every Division and Office within the Commission has participated in special initiatives to promote Year 2000 readiness in the securities industry, the capital markets, and their underlying industries.[12] Our staff has been providing reminders and guidance to companies for over a year regarding their Year 2000 disclosure obligations. To educate investors, the Office of Investor Education has posted on our web site a series of questions that investors can use.[13]

In May 1997, the Division of Corporation Finance updated its Current Issues and Rulemaking Projects outline to discuss the need for public companies to disclose the effect of Year 2000 technology problems.[14] On October 8, 1997, the Divisions of Corporation Finance and Investment Management issued a joint Staff Legal Bulletin reminding entities with disclosure obligations that our rules and regulations apply to Year 2000 issues, just like any other significant issue.[15] On January 12, 1998, the Divisions revised the Staff Legal Bulletin to provide more specific guidance under existing rules and regulations.[16]

After the Staff Legal Bulletin was revised, the Division of Corporation Finance created a Year 2000 task force to determine how many public companies are addressing the Year 2000 issue and to assess whether the disclosure being provided is meaningful. The task force found that only 10% of the annual reports filed by public companies during the first four months of 1997 contain the phrase ''Year 2000.'' For the quarterly reports filed after the staff published the Staff Legal Bulletin, this percentage increased to 25%. After the staff revised the Staff Legal Bulletin in January 1998, 70% of the annual reports contained the phrase ''Year 2000.''

To evaluate the quality of the Year 2000 disclosure, the task force read the Year 2000 disclosure in the filings of 1,023 public companies selected from 12 major industries, including 66 small business issuers. The task force believed that this sampling of filings fairly represented a cross-section of public companies. The task force also surveyed the most recent annual or quarterly reports filed by the Fortune 100

Others (''Municipal Securities Interpretive Release''), Securities Act Rel. No. 7049 (March 9, 1994), 59 FR 12748 (March 17, 1994).

[7] *SEC Staff Report on the Municipal Securities Market* (The Division of Market Regulation), September 1993, p. 1, *The Bond Buyer Securities Data Company 1998 Yearbook,* 1998, p.64.

[8] Speech of July 14, 1998 to National Academy of Science.

[9] *See, e.g.,* ''Year 2000 Time Bomb,'' *U.S. News & World Report,* June 8, 1998, page 45; ''Experts Say Bug Will Be Costly, So Will The Cure,'' *Chicago Tribune,* March 2, 1998, page C1; and ''Debunking Year 2000's Computer Disaster,'' *Los Angeles Times,* Nov. 3, 1997, page A1.

[10] Year 2000 problems have already occurred and will continue to occur before the Year 2000. The Information Technology Association of America recently conducted a survey showing that 44% of responding companies have already experienced Year 2000 disruptions in their business. This survey can be found at <http://www.itaa.org/softpr7.htm>.

[11] The United Nations recently passed a resolution calling on member states to cooperate on global awareness initiatives and called upon the public and private sectors to share Year 2000 information. *See* U.N. Passes Year 2000 Appeal (June 26, 1998) <www.news.com/News/Item/0,4,23624,00.html>. President Clinton has formed the President's Council on the Year 2000 Conversion, and the Senate has established the Senate Special Committee on the Year 2000 Technology Problem to focus and provide leadership to reduce the impact of this issue. On July 14, 1998, the President held a press conference to stress the importance of assessing and remedying the Year 2000 problem and promised to send proposed legislation to Congress addressing liability issues relevant to the Year 2000. The President's Council's web site can be found at <http://www.y2k.gov>. The Senate Special Committee Chairman, Senator Robert Bennett, has a web site with materials relating to the committee at <http://www.senate.gov/~bennett/y2k.html>. In addition, in November 1997, Senator Bennett introduced legislation, the Year 2000 Computer Remediation and Shareholder Protection Act of 1997 (S. 1518), which would require public companies to disclose their Year 2000 issues. Finally, Representatives Dreier and Cox recently introduced legislation to encourage companies to fix their Year 2000 problems, the Y2K Liability and Antitrust Reform Act (H.R. 4240).

[12] In June of 1997 and 1998, the staff provided reports to Congress on the Readiness of the Securities Industry and Public Companies to Meet the Information Processing Challenges of the Year 2000 (''Staff Report to Congress on Year 2000''). Both of these reports are on our web site at <http://www.sec.gov/news/studies/yr2000.htm> for the 1997 report and <http://www.sec.gov/news/studies/yr2000–2.htm> for the 1998 report.

[13] These questions can be found at <http://www.sec.gov/consumer/y2kaskit.htm>.

[14] The update described generally the nature of these issues and the disclosures that public companies should make. The latest Current Issues Outline can be found at <http://www.sec.gov/rules/othern> and scroll to it.

[15] The Staff Legal Bulletin contains the staff's specific guidance on good disclosure practices in the Year 2000 context.

[16] In the revised Staff Legal Bulletin, the staff's guidance focused on MD&A, but also noted that other rules might require disclosure. The staff stated that a company should disclose, at a minimum: its plans to address the Year 2000 issues that affect its business and operations, including operating systems; material effects if its customers, suppliers, and other constituents are not Year 2000 ready; its timetable for carrying out these plans; and, if material, an estimate of the Year 2000 costs and any material impact it expects these costs to have on its results of operations, liquidity, and capital resources.

companies that file periodic reports with us.[17]

Based on the specific guidance provided in the revised Staff Legal Bulletin, the task force looked for eight categories of information. The task force discovered that companies were providing a wide variety of Year 2000 disclosures. While the number of companies disclosing Year 2000 issues has increased dramatically, the task force survey shows that many companies are not providing the quality of detailed disclosure that we believe that investors would expect.[18]

In its review of Year 2000 disclosures made by investment companies, the Division of Investment Management found that twenty-four of the twenty-five largest investment company complexes have made Year 2000 disclosure to their fund shareholders. In addition, the Division surveyed 740 registration statements of investment companies filed since January 1, 1998, and found that 81% of these contained Year 2000 disclosure.[19] Typically, investment companies' Year 2000 disclosure was generic and included acknowledgment of the Year 2000 issue, that the issues are being addressed and will be resolved, and that they cannot guarantee that its remediation efforts will prevent all consequences.

The generic nature of an investment company's Year 2000 disclosure may be related to its Year 2000 compliance reliance on entities whose Year 2000 readiness efforts it does not control. Investment companies rely heavily on external service providers (*e.g.*, investment advisers, transfer agents, brokers, and custodians) that may have represented to the investment companies that they anticipate being Year 2000 compliant.

C. The Statutory Safe Harbors for Forward-Looking Information

We recognize that companies face difficult disclosure challenges due to the forward-looking nature of Year 2000 issues. In drafting disclosure documents, companies necessarily have to address uncertainties and describe future events relating to their Year 2000 issues. To help companies in this task, we provide the following interpretive guidance regarding the application of the two statutory safe harbors for forward-looking information provided by the Private Securities Litigation Reform Act of 1995.[20]

The statutory safe harbors apply to forward-looking statements [21] provided by eligible companies. [22] Almost all of the required MD&A disclosures concerning Year 2000 problems contain forward-looking statements. For example, in our view, a projection of capital expenditures or other financial items—such as the estimated costs of remediation and testing—is a forward-looking statement because it anticipates how remediation and testing will proceed in the future. [23]

A company's statement regarding the estimated future costs due to business disruption caused by vendors, suppliers, customers, or even the possible loss of electric power or phone service, typically would be a statement of future economic performance, as well as a projection of a financial item. Much of the description of a company's Year 2000 problems would be part of a forward-looking statement because the statement contains assumptions concerning estimated costs or plans for future operations. Contingency plans that assess which scenarios are most likely (such an assessment is typically necessary in deciding which scenarios to spend time and money preparing for) would be forward-looking statements of plans and objectives of management for future operations.

Some matters that are simply statements of historical fact are not forward-looking. For example, historical costs are not forward-looking. Similarly, whether a company has a contingency plan at all would be a matter of fact. Whether a company actually has performed an assessment would be a fact, as would its inventory of hardware, software, and embedded chips. However, a description of the problems that the company anticipates, which form the basis of its assessment, is sufficiently forward-looking to constitute either a forward-looking statement or an assumption relating to a forward-looking statement. Similarly, statements identifying the remediation phase that a company currently is in would be a matter of fact, but timetables for implementation of future phases, including estimates of how long the internal and third-party testing phases will take, would be forward-looking statements, at least until the phases are completed.

For the statutory safe harbors to apply, material forward-looking statements must be accompanied by ''meaningful cautionary statements.'' [24] The meaningful cautionary statements cannot be boilerplate language.[25] The safe harbors do not apply if the statement was knowingly false when made. Furthermore, the statutory safe harbors were meant to apply only to private actions in federal court.[26]

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[17] Seven of the Fortune 100 companies are not required to file periodic reports with us.

[18] The task force survey is on our web site <http://www.sec.gov/news/extra/y2kcfty.htm>.

[19] The Division of Investment Management also reviewed the disclosure of all of the public utility holding companies registered with us under the Public Utility Holding Company Act of 1935. While we regulate the corporate and financial structure of registered public utility holding companies under that Act, these companies are subject to the same disclosure obligations as other public companies, including the MD&A requirement. The interpretive guidance provided in this release is therefore specifically applicable to public utility holding companies.

[20] There is a statutory safe harbor for both the Securities Act and the Exchange Act. *See* Section 27A of the Securities Act (15 U.S.C. 77z-2) and Section 21E of the Exchange Act (15 U.S.C. 78u-5). The statutory safe harbors have certain limitations. For example, the safe harbors do not by their terms apply to lawsuits in state court. We note, however, that pending legislation would address class actions brought in state court. The Securities Litigation Uniform Standards Act of 1998, S. 1260, and its companion bill, H.R. 1689, recently have been passed by Congress.

[21] ''Forward-looking statement'' is defined in Section 27A to include: (A) a statement containing a projection of revenues, income, earnings, capital expenditures, or other financial items; (B) a statement of the plans and objectives of management for future operations; (C) a statement of future economic performance; [and] (D) any statement of the assumptions underlying or relating to any statement described in subparagraph (A), (B), or (C).

In addition, Securities Act Rule 175 (17 CFR 230.175) and Exchange Act Rule 3b–6 (17 CFR 240.3b–6) provide some protection for similar ''forward-looking statements'' that may apply to companies that are excluded from the statutory safe harbors.

[22] The statutory safe harbors apply to disclosures made by: a company; a person acting on behalf of the company; an outside reviewer retained by the company making a statement on behalf of the company; or an underwriter, with respect to information derived from information provided by the company. *See* Securities Act Section 27A(a) and Exchange Act Section 21E(a). There are exclusions from the statutory safe harbors for specific types of filings, and companies need to review the safe harbors before relying on them. For example, the safe harbors are not available to initial public offerings or investment companies. *See* Securities Act Section 27A(b) and Exchange Act Section 21E(b).

[23] Statements included in a financial statement prepared in accordance with generally accepted accounting principles are not covered by the statutory safe harbors. *See* Securities Act Section 27A(b)(2)(A) (15 U.S.C. 77z–2(b)(2)(A)); Exchange Act Section 21E(b)(2)(A) (15 U.S.C. 78u–5(b)(2)(A)). Consequently, statements of estimated costs included in MD&A disclosure outside the financial statements would generally be covered. Inclusion of those costs in the financial statements, or discussion of them in the footnotes to the financial statements would be not be covered.

[24] Securities Act Section 27A(c)(1)(A)(i) (15 U.S.C. 77z–2(c)(1)(A)(i)); Exchange Act Section 21E(c)(1)(A)(i) (15 U.S.C. 78u–5(c)(1)(A)(i)). Further, certain courts have adopted the ''bespeaks caution'' doctrine to afford protection of forward-looking statements that are accompanied by full and meaningful discussion of their limitations and assumptions *See, e.g., In re Donald J. Trump Casino Sec. Litig.*, 7 F.3d 357 (3rd Cir. 1993), *cert. denied*, 114 S.Ct. 1219 (1994).

[25] *See* H.R. Conf. Rep. No. 104–369 (1995).

[26] Securities Act Section 27A(c)(1) (15 U.S.C. 77z–2(c)(1)); Exchange Act Section 21E(c)(1) (15

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III. Our Specific Disclosure Guidance

As the end of the century draws near, the Year 2000 technical and legal issues become increasingly material to investors. We are concerned that some companies may not be meeting their Year 2000 disclosure obligations. With each passing month, the extent of the Year 2000 risks become more evident and companies' obligations to disclose their Year 2000 issues becomes clearer. Investors need to know how companies are addressing these issues.

The federal securities laws are dynamic and responsive to changing circumstances. As companies remediate their Year 2000 issues, their circumstances change as they discover new issues. Companies need to adjust their disclosure accordingly. In almost all cases, companies will have material events and changes requiring updated Year 2000 disclosure in each quarterly and annual report filed with us.[27]

A. Specific Guidance for Year 2000 Disclosure Under MD&A

The following specific guidance sets forth the type of Year 2000 disclosure that companies should provide under MD&A and other rules and regulations.

1. Basic MD&A Analysis

MD&A is intended to give investors the opportunity to look at a company through the eyes of management by providing both a short and long-term analysis of the company's business—with particular emphasis on the company's prospects for the future. MD&A requires a discussion of liquidity, capital resources, results of operations, and other information necessary to an understanding of a company's financial condition, changes in financial condition, and results of operations. The language of the MD&A requirement is intentionally general. This reflects our view that a flexible approach best elicits meaningful disclosure and avoids boilerplate discussions.

One of the challenges that a company faces when drafting its MD&A is discussing forward-looking information. One of the few regulations that require forward-looking disclosure, MD&A contains a variety of formulations calling for this information, including a requirement to disclose known material events, trends or uncertainties.[28]

In the 1989 Release, we gave guidance to companies on various aspects of MD&A disclosure. Under the 1989 Release, companies should apply the following analysis to determine if they should disclose forward-looking information.

Where a trend, demand, commitment, event, or uncertainty is known, management must make two assessments:

(1) Is the known trend, demand, commitment, event or uncertainty likely to come to fruition? If management determines that it is not reasonably likely to occur, no disclosure is required.

(2) If management cannot make that determination, it must evaluate objectively the consequences of the known trend, demand, commitment, event or uncertainty on the assumption that it will come to fruition. Disclosure is then required unless management determines that a material effect on the company's financial condition or results of operations is not reasonably likely to occur. The determination made by management must be objectively reasonable, viewed as of the time the determination is made.

This test essentially requires companies to disclose forward-looking information based on currently known events, trends or uncertainties that are reasonably likely to have material effects on the company's financial condition or results of operations.[29] Because of the prevalence of computers and embedded technology in virtually all businesses and the potential consequences of not adequately addressing the Year 2000 problem, we believe that almost every company will need to address this issue.

2. How We Interpret MD&A in the Year 2000 Context''

a. *Whether to Disclose Year 2000 Issues.* The first decision that a company must make is whether it has an obligation to provide any disclosure regarding its Year 2000 issues.[30] By applying the 1989 Release's guidance regarding forward-looking information, we believe that a company must provide Year 2000 disclosure if:

(1) Its assessment of its Year 2000 issues is not complete, *or*

(2) Management determines that the consequences of its Year 2000 issues would have a material effect on the company's business, results of operations, or financial condition, without taking into account the company's efforts to avoid those consequences.

Our two-part test is substantially similar to the revised Staff Legal Bulletin's guidance for whether companies have a Year 2000 disclosure obligation. We believe that a large majority of companies will meet one or both of these tests and therefore will be required to provide Year 2000 disclosure. We expect that significantly more companies will be providing Year 2000 disclosure in future disclosure documents than the 70% found by the task force.

Under the first test, a company's assessment should take into account whether third parties with whom a company has material relationships are Year 2000 compliant. The determination of whether a relationship is material depends on the nature of the relationship.

For vendors and suppliers, the relationship is material if there would be a material effect on the company's business, results of operations, or financial condition if they do not timely become Year 2000 compliant. The same analysis should be made for significant customers whose Year 2000 readiness could cause a loss of business that might be material to the company. The company also should consider its potential liability to third parties if its systems are not Year 2000 compliant, resulting in possible legal actions for breach of contract or other harm.

In our view, a company's Year 2000 assessment is not complete until it considers these third party issues and takes reasonable steps to verify the Year 2000 readiness of any third party that could cause a material impact on the

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U.S.C. 78u–5(c)(1)). In contrast, Securities Act Rule 175 and Exchange Act Rule 3b–6 also would apply to Commission actions.

[27] Item 303(b) of Regulation S–K (17 CFR 229.303(b)) and Item 303(b)(2) of Regulation S–B (17 CFR 229.303(b)(2)) set forth the MD&A requirements for interim reports. In a 1989 interpretive release (''1989 Release''), we noted that companies need to update known trends, demands, commitments, events, and uncertainties for any material change in each subsequent periodic report. Securities Act Rel. No. 6835 (May 18, 1989), 54 FR 22427 (May 24, 1989), text at note 40.

[28] A general instruction in MD&A states that companies ''shall focus sepcifically on material events and uncertainties known to management that would cause reported financial information not to be necessarily indicative of future operating results or of future financial condition.'' Item 303(a) of Regulation S–K, Instruction 3 (17 CFR 229.303(a)). For small businesses, Item 303(b) of Regulation S–B (17 CFR 228.303(b)) states in part that ''discussion should address the past and future financial condition and results of operation of the small business issuer * * *'' for each of the last two fiscal years. Item 303(b) of Regulation S–B contains an instruction (Instruction 1) similar to Instruction 3 of Item 303(a).

[29] In addition to the analytical guide, the 1989 Release provides several examples of forward-looking disclosure. These may be useful to help companies determine the type of forward-looking information that should be provided when they have triggered the 1989 two-part test.

[30] The Year 2000 issue is certainly ''known'' to all companies. The problems associated with this issue have been widely publicized, and no company can reasonably argue that it does not know about the Year 2000 issue.

company. We understand that this is often done by analyzing the responses to questionnaires sent to these third parties. In the absence of receiving responses to questionnaires, there may be other means to assess third party readiness.[31]

Under the second test, companies must determine whether they have a Year 2000 disclosure obligation by evaluating their Year 2000 issues on a ''gross'' basis.[32] In other words, in the absence of clear evidence of readiness, a company must assume that it will not be Year 2000 compliant and weigh the likely results of this unpreparedness.[33] As part of this analysis, the company must assume that material third parties will not be ready either, unless these third parties have delivered written assurances to the company that they expect to be Year 2000 compliant in time. The test is driven by measuring the consequences if the company is not prepared, rather than the amount of money the company spent, or plans to spend, to address this issue.[34]

b. *What to Disclose about Year 2000 Issues.* Once a company determines that it has a Year 2000 disclosure obligation, it has to decide what to disclose about its Year 2000 issues. MD&A does not require categories of specific information because each company has to consider its own circumstances in drafting its MD&A. For Year 2000 disclosure to be meaningful, we believe that companies will have to address the following four categories of information in their MD&A, as discussed in more detail below:

(1) The company's state of readiness;
(2) The costs to address the company's Year 2000 issues;
(3) The risks of the company's Year 2000 issues; and
(4) The company's contingency plans.

The disclosure should be specific to each company and quantified to the extent practicable. Some companies may have to provide this information by business segment or subdivision.[35] Companies should avoid generalities and boilerplate disclosure. In addition, each company must consider if its own Year 2000 circumstances require that additional matters be disclosed.

(1) The Company's State of Readiness. When a company has to provide disclosure regarding a known material event, trend, or uncertainty, it first has to describe that event, trend, or uncertainty.[36] A company should describe its Year 2000 issues in sufficient detail to allow investors to fully understand the challenges that it faces. We suggest that the description be similar to that provided to a company's board of directors—which typically is non-technical plain English and answers the important questions—such as ''will we be ready?'' and ''how far along are we?'' So far, most companies have provided only a cursory description of their Year 2000 issues.

A full description of a company's Year 2000 readiness will generally include, at the very least, the following three elements. First, the discussion should address both information technology (''IT'') and non-IT systems.[37] Non-IT systems typically include embedded technology such as microcontrollers.[38] These types of systems are more difficult to assess and repair than IT systems. In fact, companies often have to replace non-IT systems since they cannot be repaired. To date, only a few companies have addressed non-IT issues in their disclosure.[39] We are concerned that companies are overlooking non-IT systems when they provide Year 2000 disclosure.[40]

Second, for both their IT and non-IT systems, companies should disclose where they are in the process of becoming ready for the Year 2000.[41] The status of the company's progress, identified by phase, including the estimated timetable for completion of each remaining phase, is vital information to investors and should be disclosed.[42] There are no universal definitions for the phases in a Year 2000 remediation program.[43] However, for the most part, the phases are self-explanatory, and we recommend that companies briefly describe how they define each phase. Another challenge is describing the status of multiple computer systems. Companies should tailor the disclosure and the format for their own particular circumstances.[44]

The third essential component is a description of a company's Year 2000 issues relating to third parties with which they have a material relationship. Due to the interdependence of computer

[31] A company's statement of its own readiness based on third party representations would be forward-looking and fall within the statutory safe harbors. Further, a company's reasonable reliance on the third party statements would be assumptions underlying that statement and also entitled to safe harbor protection.

[32] The gross basis determination is similar to the analysis in Staff Accounting Bulletin (SAB) No. 92 (June 8, 1993) relating to accounting and disclosures related to loss contingencies. In SAB No. 92, our staff gave guidance regarding the need to separately disclose environmental liabilities and related potential claims for recovery, unless the recovery was probable. The staff stressed the uncertainties related to potential claims for recovery. We stress in this release the uncertainties related to remediation, third parties, litigation, insurance coverage and other contingencies in the Year 2000 context.

[33] If a company has substantially completed its testing and assessment of third party issues, and thus has a reasonable basis to believe that it is Year 2000 ready, it need not make this assumption. Thus, MD&A disclosure may not be required, although we encourage all companies to address the Year 2000 issue and describe their Year 2000 status.

[34] In considering whether potential Year 2000 consequences are material, companies may offset quantifiable dollar amounts of those consequences that would be covered by Year 2000-specific insurance policies, provided that the policies have a sufficiently broad coverage to cover all risks.

[35] Item 303(a) of Regulation S–K (17 CFR 229.303(a)).

[36] For example, Instruction 3 to Item 303(a) of Regulation S–K (17 CFR 229.303(a)) states that the discussion and analysis should include ''descriptions and amounts'' of matters that would have an impact on future operations and have not had an impact in the past.

[37] Companies in some industries, such as software and hardware manufacturers, also may need to discuss whether their products will be Year 2000 compliant, and related consequences.

[38] For example, most equipment and machinery, such as elevators, contain microcontrollers. For more information regarding the Year 2000 risks of embedded technology, *see* the Institution of Electrical Engineers web site, <http://www.iee.org/2000risk>

[39] Reportedly, some companies only recently became aware that their non-IT systems have Year 2000 issues. *See, e.g.,* ''Industry Wakes Up to Year 2000 Menace,'' *Forbes,* April 27, 1998 at 163.

[40] A good description of a company's Year 2000 issues would address whether all its hardware and software systems, and all of its embedded systems contained in the company's buildings, plant, equipment and other infrastructure, have been assessed. If this assessment is not complete, the company should disclose the kinds and percentage of hardware and software systems and embedded systems that remain to be assessed.

[41] Companies should discuss their progress in a manner that will best inform investors about where the company is on their timetable. For example, some companies may decide that the amount of money spent may be their best indicator of progress, while other companies may decide that labor still required to be undertaken may be a more appropriate indicator.

[42] We are particularly concerned about the testing phase. Experts have stated that companies with numerous systems and third party relationships should be planning to conduct testing for at least one year. Serious consideration should be given to disclosing, as of the end of each reporting period: (1) What kinds and percentage of the company's hardware and software systems have been tested and verified as Year 2000 compliant, (2) what kinds and percentage of embedded systems have been tested and verified as Year 2000 compliant, and (3) what testing and verification methodology was used.

[43] Public companies and municipal issuers should consider the phases identified by the General Accounting Office in its checklist guide to Federal agencies. The guide describes five phases representing a major Year 2000 activity or segment—awareness, assessment, renovation, validation, and implementation. General Accounting Office, GAO/AIMD–10.1.14, Year 2000 Computing Crisis: An Assessment guide (1997). The guide is available as a PDF file on the GAO web site at <http://www.gao.gov/y2kr.htm>. Investment advisers and investment companies should consider the phases identified in our Investment Advisers Year 2000 Reports release, cited in note 68 below.

[44] Companies may want to disclose the average phase for all of their mission critical systems or may want to use a chart to disclose the status for each mission critical system.

systems today, the Year 2000 problem presents a unique policy issue. For example, if a major telecommunications company discloses that it may have a business interruption, this may require many other companies to disclose that they too may have a business interruption, if material. Thus, each company's Year 2000 issues may affect other companies' disclosure obligations. Companies should disclose the nature and level of importance of these material relationships, as well as the status of assessing these third party risks.[45]

(2) The Costs to Address the Company's Year 2000 Issues. Companies must disclose material historical and estimated costs of remediation. This includes costs directly related to fixing Year 2000 issues, such as modifying software and hiring Year 2000 solution providers. In most cases, the replacement cost of a non-compliant IT system should be disclosed as an estimated Year 2000 cost. This is so even if the company had planned to replace the system and merely accelerated the replacement date.[46] A company does not need to include the replacement cost as a Year 2000 estimated cost if it did not accelerate the replacement due to Year 2000 issues.

(3) The Risks of the Company's Year 2000 Issues. Companies must include a reasonable description of their most reasonably likely worst case Year 2000 scenarios. The essence of MD&A is whether the consequences of a known event, trend, or uncertainty are likely to have a material effect on the company's results of operations, liquidity, and financial condition. If a company does not know the answer, this uncertainty must be disclosed, as well as the efforts made to analyze the uncertainty and how the company intends to handle this uncertainty. For example, companies must disclose estimated material lost revenue due to Year 2000 issues, if known.

(4) The Company's Contingency Plans. Companies must describe how they are preparing to handle the most reasonably likely worst case scenarios. This information will help investors evaluate the company's Year 2000 exposure by answering the important question—''what will the company do if it is not ready?'' Under this category of information, the company must describe its contingency plans.[47] We recognize that describing contingency plans may be particularly challenging. Many companies have not yet established a contingency plan. In this case, the company should disclose that it does not have a contingency plan, whether it intends to create one, and the timetable for doing so.

(5) Suggested Disclosure. We cannot address the virtually unlimited number of differing circumstances relating to Year 2000 issues that may require a company to provide disclosure. For example, the departure of a senior management member who heads the company's Year 2000 project may be material for some companies but not all companies. Some companies face material Year 2000 risks outside the United States.[48] Software and hardware manufacturers must address whether their products will be Year 2000 compliant and may face potentially greater litigation risks than companies in other industries. Companies regulated by other agencies, such as financial institutions, may face formal supervisory or enforcement actions relating to Year 2000 issues that need to be disclosed.[49]

Companies must be aware that providing the minimum level of Year 2000 disclosure set forth in the four categories of information above may not be enough to meet their disclosure obligations. Each company must consider if its own Year 2000 circumstances require disclosure of other matters. The following suggestions are intended to help companies meet their disclosure obligations. While each of the suggestions may not be relevant for each company, all companies should consider them.

1. Disclose historical and estimated costs related to their Year 2000 issues, even if disclosure of the dollar amounts is not required because these amounts are not material.

2. As of the end of each reporting period, disclose how much of the total estimated Year 2000 project costs have already been incurred.

3. Identify the source of funds for Year 2000 costs, including the percentage of the IT budget used for remediation. This allows investors to determine whether Year 2000 funds will be deducted from the company's income.

4. Explain if other IT projects have been deferred due to the Year 2000 efforts, and the effects of this delay on financial condition and results of operations.

5. Describe the use of any independent verification and validation processes to assure the reliability of their risk and cost estimates. The use of independent verification may be particularly important in the testing phase.[50]

6. Use a chart to provide Year 2000 disclosure. The chart may help investors track a company's progress over time, as it is updated, and make peer comparisons based on the same data. In addition, a chart can reduce lengthy Year 2000 disclosure that otherwise may overwhelm other disclosure.

7. Include a breakdown of the costs, such as disclosure of costs to repair software problems, and costs to replace problem systems and equipment.

B. Year 2000 Financial Statement Considerations

Existing accounting and auditing standards provide guidance concerning the accounting and disclosure issues arising from the Year 2000 problem. Matters that companies and their auditors should consider include the following.

1. Accounting and Disclosure in Financial Statements

Costs of Modifying Software. A company's need or plan to modify its own software for Year 2000 compliance does not result in a liability that is

[45] Item 101(c)(vii) of Regulation S–K sets forth the circumstances under which identification of material customers is required. 17 CFR 229.101(c)(vii).

[46] If a system is replaced, as part of the description of phase progress, a company should disclose the date of replacement and the status of testing for Year 2000 compliance with the new system.

[47] For example, a company might disclose that it stands ready to switch vendors, has back-up systems that do not rely on computers, or has stockpiled raw materials in the months before Year 2000. Contingency plans typically include: identification of the companies' systems and third party risks that the plan addresses; an analysis of strategies and available resources to restore operations; and a recovery program that identifies participants, processes, and any significant equipment needed.

[48] It is widely reported that some countries, and organizations within those countries, are not intensively acting to remediate their Year 2000 issues. *See, e.g.,* ''Governments Aid Companies in Preparation,''*Journal of Commerce,* Feb. 25, 1998, page A4.

[49] In November 1997, the FDIC issued Orders to Cease and Desist against three Georgia banks relating to Year 2000 readiness. *See* FDIC Press Release, ''Orders to Cease and Desist Issued Against Georgia Banks,'' PR–83–97 (11/17/97), <http://www.fdic.gov/publish/archive/press/97 press/pr9783.html>.

[50] Companies may retain experts or advisers to evaluate their Year 2000 readiness. The retention of experts and whether an evaluation has been performed would be historical facts. Statements made by the experts about the company's readiness likely would be statements ''on behalf of the company'' about its future economic performance and therefore entitled to protection under the statutory safe harbors. Similarly, the company's disclosure of the expert's evaluation is likely to be an assumption regarding its own statement of future economic performance and fall within the statutory safe harbor.

recognized in financial statements. Instead, the costs of modifying the software are charged to expense as they are incurred.[51]

Costs of Failure to Be Year 2000 Compliant. Operating losses expected to result if a company, its suppliers, or customers fail to correct Year 2000 deficiencies are recognized only as they are incurred.

Disclosure of Year 2000 Related Commitments. Companies should consider the need to disclose payments to be made pursuant to unfulfilled or executory contracts or commitments with vendors to remediate Year 2000 noncompliance problems.[52]

Companies also should consider the need to disclose the potential for acceleration of debt payments due to covenant defaults tied to Year 2000 readiness.

Revenue and Loss Recognition. Year 2000 issues may affect the timing of revenue recognition in accordance with AICPA Statement of Position 97–2, *Software Revenue Recognition*. For example, if a vendor licenses a product that is not Year 2000 compliant and commits to deliver a Year 2000 compliant version in the future, the revenue from the transaction should be allocated to the various elements—the software and the upgrade. Entities also should consider FASB Statement No. 48, *Revenue Recognition When the Right of Return Exists*, relating to any product return issues such as for products containing hardware and software, including whether the necessary conditions have been met to recognize revenue in the period of sale, whether that revenue should be deferred, or whether an allowance for sales return should be provided.

Allowances for Loan Losses. The credit quality of a loan may be affected by the failure of a borrower's operating or other systems as a consequence of a Year 2000 issue or a borrower's failure to comply with debt covenant terms regarding Year 2000 issues. Creditors' allowances for loan losses, however, should be provided only for losses incurred as of the balance sheet date, and should not be based on the effects of future events.

Losses from Breach of Contract. Possible losses from asserted and nonasserted claims of breach of contract or warranty due to Year 2000 noncompliance must be disclosed in notes to the financial statements, and must be recognized as a liability if those losses are probable and reasonably estimable.[53] For example, companies selling products with an express or implied warranty of Year 2000 compliance may have a potential liability that must be evaluated at each balance sheet date. Companies will be required to disclose potential lawsuits when there is at least a reasonable possibility that a loss, or additional loss, may be incurred even if the amount of loss cannot be reasonably estimated.

Impairment of Assets. Certain companies may need to consider if a write-down of capitalized software may be required in accordance with the guidance of FASB Statement No. 86, *Accounting for the Costs of Computer Software to Be Sold, Leased or Otherwise Marketed.* Also, Year 2000 compliance issues may indicate impairment of long-lived assets that contain hardware or software and require application of the guidance in FASB Statement No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of.* An adjustment to the estimated useful lives of hardware or internal use software may be appropriate even if the assets are not considered to be impaired. In addition, companies should consider the accounting for costs associated with developing or obtaining computer software for internal use, as discussed in AICPA Statement of Position 98–1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use.*

Disclosure of Risks and Uncertainties. A company must explain any risk or uncertainty of a reasonably possible change in its estimates in the near term that would be material to the financial statements. Examples of estimates that may be affected by Year 2000 issues include estimates of warranty liability, reserves for product returns and allowances, capitalized software costs, inventory, litigation, and deferred revenue.[54]

Additional guidance concerning accounting and auditing issues related to the Year 2000 issue is included in *The Year 2000 Issue—Current Accounting and Auditing Guidance*, published by the AICPA on October 31, 1997.[55]

2. Auditor Responsibilities

Conducting the Audit. Existing generally accepted auditing standards provide guidance that would apply to performing an audit involving Year 2000 issues. The AICPA publication, *The Year 2000 Issue—Current Accounting and Auditing Guidance*, also addresses auditing issues related to the Year 2000 issue. The auditor should consider professional standards concerning matters such as planning and supervision of the audit, auditor responsibilities for disclosures outside the financial statements in filings made with us, processing of transactions by service organizations, and auditor communications with the client, management and audit committee.[56]

Although the term ''may'' is used throughout the AICPA's guidance, perhaps suggesting that the guidance is discretionary, we believe that the procedures outlined by the AICPA should be considered appropriate practice at this time and we expect companies and their auditors to comply with that guidance. If they do not, they should be prepared to justify why the procedures were not followed.[57]

''Going Concern'' Issues. An auditor must evaluate whether or not the procedures performed during the course of the audit identify conditions and events that, in the aggregate, indicate there could be substantial doubt about the entity's ability to continue as a going concern. Year 2000 issues, either alone or when considered in relation to other conditions and events, may indicate going concern issues about an entity. The going concern issues may affect the disclosures in the financial statements and result in a modification of the auditor's report.[58]

Resignation of an Independent Auditor. Item 4 of Form 8–K requires a company to file a Form 8–K within 5 business days if its principal auditor resigns.[59] The company must disclose in the Form 8–K any disagreements on accounting or reportable events that relate to Year 2000 issues. The company must request the auditor to review its

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[51] *See* Emerging Issues Task Force (''EITF''), Issue No. 96–14, ''Accounting for the Costs Associated with Modifying Computer Software for the Year 2000,'' which notes the remarks of our former Chief Accountant, Michael Sutton, at the July 23–24, 1997 meeting of the EITF that future costs to modify software for Year 2000 problems are not a currently liability, and the staff would object to the accrual of such costs.

[52] *See* FASB Statement No. 5, paragraph 18. *See also* AICPA, Statement of Position 94–6, ''Disclosure of Significant Risks and Uncertainties.''

[53] *See* FASB Statement No. 5, paragraphs 24–26.

[54] *See* AICPA, Statement of Position 94–6, ''Disclosure of Significant Risks and Uncertainties.''

[55] This publication can be found on the AICPA web site at <http://www.aicpa.org/members/y2000/intro.htm>.

[56] *See* AICPA, Codification of Statements on Auditing Standards, section (''AU Section'') 311, ''Planning and Supervision.''

[57] In the 1998 Staff Report to Congress on Year 2000, our Office of Chief Accountant expressed this view on page 49.

[58] *See* AU Section 9341, ''Effect of the Year 2000 Issue on the Auditor's Consideration of an Entity's Ability to Continue as a Going Concern.''

[59] Form 8–K (17 CFR 249.308).

disclosures and invite comment on their completeness and accuracy.

C. General Guidance for Public Companies' Year 2000 Disclosure Under Other Regulations

Other federal securities rules or regulations may require disclosure related to companies' Year 2000 issues. The following is a list of rules and regulations that companies should consider.

1. Description of Business [60]

This item requires a description of the general development of the business of the company, its subsidiaries, and any predecessors during the past five years (or the period the company has been in business, if shorter). Among other things, this item requires a discussion of:

—Any material changes in the mode of conducting the business;
—The principal markets for the company's products and services;
—Competitive conditions in the business; and
—Financial and narrative information about the company's industry segments.

2. Legal Proceedings.[61]

A company must describe material pending legal proceedings in which the company or any of its subsidiaries is a party, or to which its property is subject. Generally, no information is required regarding claims for damages unless the amount involved exceeds ten percent of the current assets of the company and its subsidiaries on a consolidated basis. However, it may be necessary to describe routine litigation where the claim differs from the usual type of claim [62]

3. Material Contracts [63]

A company must file as an exhibit certain contracts that are considered material to its business. These contracts include contracts upon which the business is substantially dependent, such as contracts with principal customers and principal suppliers.

4. Risk Factors [64]

Registration statements filed under the Securities Act must include under the caption ''Risk Factors'' a discussion of the factors that make the offering speculative or risky. This discussion must be specific to the particular company and its operations, and should explain how the risk affects the company and/or the securities being offered. Generic or boilerplate discussions do not tell investors how the risk may affect their investment.

5. Form 8–K [65]

Year 2000 issues may reach a level of importance that prompts a company to consider filing a Form 8–K under Item 5 of the form. In considering whether to file a Form 8–K, companies should be particularly mindful of the accuracy and completeness of information in registration statements filed under the Securities Act that incorporate by reference Exchange Act reports, including Forms 8–K.[66]

6. Any Additional Material Information Necessary to Make the Required Disclosure Not Misleading

In addition to the information that the company is specifically required to disclose, the disclosure rules require disclosure of any additional material information necessary to make the required disclosure not misleading.[67]

D. Guidance for Year 2000 Disclosure for Investment Advisers and Investment Companies

Because of the key role that investment advisers and the investment companies they manage play in the financial markets, we believe that it is important that investment advisers provide detailed reports on their Year 2000 readiness to the Commission. In June 1998, we published for comment a proposed rule to require investment adviser Year 2000 reports.[68] Since these reports will be publicly available, they will help analysts and the public, as well as the Commission, to evaluate the progress of investment companies and investment advisers in addressing the Year 2000 issue. In addition to these reports, investment companies and investment advisers that conclude that the Year 2000 issue is material to their operating results and/or financial condition are required to provide disclosure in accordance with other statutory provisions.

The anti-fraud provisions of the Investment Advisers Act generally impose on investment advisers an affirmative duty, consistent with their fiduciary obligation, to disclose to clients or prospective clients material facts concerning their advisory or proposed advisory relationships.[69] If the failure to address the Year 2000 issue could materially affect the advisory service provided to clients, an adviser that will not be able to, or is uncertain about, its ability to address Year 2000 issues has an obligation to disclose that information to its clients. The adviser must provide the disclosure in a timely manner so that the clients and prospective clients may take steps to protect their interests. In addition, investment advisers that are public companies have disclosure obligations under the Securities Act and Exchange Act and should follow our interpretive guidance for public company disclosure in Sections III. A, B, and C.

The Investment Company Act provides that it is unlawful for investment companies to omit from registration statements and other public filings ''any fact necessary in order to prevent the statements made therein, in light of the circumstances under which they were made, from being misleading.'' [70] If investment companies determine that their Year 2000 risks are material, they are required to discuss such risks in their registration statements and other public documents and should follow the guidance provided in this section. [71]

[60] Item 101 of Regulation S–K (17 CFR 229.101). Item 101 of Regulation S–B (17 CFR 228.101) and Item 1 of Form 20–F require similar disclosure. A company may need to address Year 2000 issues related to each reportable segment.

[61] Item 103 of Regulations S–K (17 CFR 229.103) and S–B (17 CFR 228.103), and Item 3 of Form 20–F.

[62] Instruction 1 to Item 103 of Regulation S–K, and Item 3, of form 20–F.

[63] Item 601(b)(10) of Regulations S–K (17 CFR 229.601(b)(10)) and S–B (17 CFR 228.601(b)(10)), and Item 19 of Form 20–F.

[64] Item 503(c) of Regulations S–K and S–B. This item was amended in Securities Act Release No. 7497 (January 28, 1998) to require companies to describe risk factors in plain English. 63 FR 6370 (Feb. 6, 1998). This amendment takes effect October 1, 1998.

[65] Item 5 may be used by a company to report on Form 8–K any events, for which information is not otherwise required by the form, that the company deems of importance to securityholders.

[66] General Instruction B.4 of Form 8–K.

[67] Securities Act Rule 408 (17 CFR 230.408), Exchange Rules 12b–20 (17 CFR 240.12b–20) and 14a–9 (17 CFR 240.14a–9). Companies also should consider the anti-fraud provisions of the Securities Act and the Exchange Act. These anti-fraud requirements apply to statements and omissions both in Commission filings and outside of Commission filings. Securities Act Section 17(a), Exchange Act Section 10(b), and Exchange Act Rule 10b–5. Companies also should consider potential civil liabilities under Securities Act Sections 11 (15 U.S.C. 77k) and 12(a)(2) (15 U.S.C. 77l(a)(2)) and Exchange Act Section 18 (15 U.S.C. 78r).

[68] Investment Advisers Year 2000 Reports, Release Nos. IA–1728 and IC–23293 (June 30, 1998), 63 FR 36632 (July 7, 1998), <http://www.sec.gov/rules/proposed/ia–1728.htm>. Comments must be received on or before August 10, 1998.

[69] Sections 206 (1) and (2) of the Investment Advisers Act of 1940 (15 U.S.C. 80b–6 (1) and (2)). *See SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963).

[70] Section 34(b) of the Investment Company Act of 1940 (15 U.S.C. 80a–33(b)).

[71] In evaluating these risks, investment companies should consider whether Year 2000 issues present material risks for their investment portfolios as well as for investment company operations. *See, eg.*,

Whether Year 2000 issues are material depends upon the particular facts and circumstances for each investment company. Consideration should be given, for example, to whether Year 2000 issues affect an investment company's own operations, and its ability to obtain and use services provided by third parties, or its portfolio investments. Investment companies could face difficulties, among other things, performing various functions such as calculating net asset value, redeeming shares, delivering account statements and providing other information to shareholders. Because many investment company operations are performed by external service providers, we expect that investment companies would, as a matter of course, discuss Year 2000 issues with their service providers and seek reasonable assurance from these service providers that they will address Year 2000 issues so as to allow the continuation of the provided services without interruption, and consider carefully the responses provided.[72]

Discussion of Year 2000 issues and their effect on an investment company may need to be made in response to specific items of the registration forms for investment companies. For example, open-end investment companies (mutual funds) are required by Item 6 of Form N–1A to describe in their prospectuses the experience of their investment adviser and the services that the adviser provides. In response to this item, investment companies may need to disclose the effect that the Year 2000 issue would have on their advisers' ability to provide services described in their registration statements. Item 7 of that form requires funds to describe their pricing procedures and purchase and redemption procedures. Investment companies should consider the effect of Year 2000 issues on the effectiveness and operation of these procedures. Investment companies also may need to consider the effect of the Year 2000 issue in discussing their investment strategies and risks, and consider whether their investment objectives or policies need to be changed in light of Year 2000 concerns.[73]

Although those provisions are not specifically applicable to investment companies, investment companies seeking further guidance in preparing Year 2000 disclosure may find it helpful to review the provisions of this release applicable to other public companies and their preparation of MD&A disclosure. For example, investment companies may find it appropriate to include disclosure about the costs of remedying their Year 2000 issues, any liabilities associated with these problems, or contingency plans to deal with their disruptions that may occur when Year 2000 issues are encountered.

Investment companies that conclude that the Year 2000 is not material to their financial operating results and/or financial condition may nonetheless choose to include Year 2000 disclosure in periodic reports to shareholders or in special reports to shareholders on Year 2000 matters. We encourage such reporting, and consider that it is particularly appropriate in cases in which an investment company concludes that the materiality of the problem does not trigger a disclosure obligation in a registration statement. Finally, when providing Year 2000 disclosure, investment advisers and investment companies should avoid boilerplate disclosure that may not be meaningful to shareholders.

E. Guidance for Year 2000 Disclosure for Municipal Issuers

Generally, municipal securities offerings are exempt from registration and municipal securities issuers are exempt from the reporting provisions of the federal securities laws, including line-item disclosure rules. However, they are not exempt from the anti-fraud provisions. Disclosure documents used by municipal issuers are subject to the prohibition against false or misleading statements of material facts, including the omission of material facts necessary to make the statements made, in light of the circumstances in which they are made, not misleading.[74]

Issuers of municipal securities and persons assisting in preparing municipal issuer disclosures are encouraged to consider whether such disclosures should contain a discussion of Year 2000 issues. Persons, including ''obligated persons'' as defined in Rule 15c2–12,[75] who provide information for use in disclosure documents or in ongoing disclosure to the market, are urged to consider their own Year 2000 issues. Year 2000 issues should be considered in preparing all disclosure documents, whether in the context of an official statement, continuing disclosure provided in compliance with a disclosure covenant, or other information that is reasonably expected to reach investors and the trading markets.[76]

Whether Year 2000 issues are material depends upon the particular facts and circumstances for each municipal issuer. Consideration may be given, for example, to whether Year 2000 issues affect internal operations of an issuer or affect an issuer's ability to provide services and meet its obligations, including timely payment of its indebtedness.

Because of the varieties of municipal issuers and of municipal securities, the examples provided below may or may not apply to a particular issuer and an issuer may be subject to facts and circumstances requiring disclosure not described below. Issuers and the persons assisting in disclosure preparation should give careful consideration to Year 2000 issues within the context of the facts and circumstances applicable to the disclosing issuer or the securities.

Examples of Potential Year 2000 Problems

For municipal issuers, Year 2000 issues may be divided into three categories: Internal, External and Mechanical. Internal Year 2000 issues may arise from an issuer's own operations and materially affect its creditworthiness and ability to make timely payment of its obligations. External Year 2000 issues may arise from parties, other than an issuer, that provide payments that support the debt service on an issuer's municipal securities. Such payments may include, for example, health care reimbursement payments and payments under housing and student loan programs, as well as payments made by an obligated person under a lease, loan or installment sale agreement in a conduit financing.

Mechanical Year 2000 issues may arise if Year 2000 problems disrupt the actual mechanical process used to send payments to bondholders. For example, many municipal securities pay interest semiannually on January 1 and July 1 of each year, or have periodic sinking fund installments due to an indenture trustee or fiscal agent. Issuers may wish to determine whether Year 2000 issues affect their ability to identify and meet such obligations in a timely manner and to disclose any measures that will be undertaken if an issuer determines it

Item 4 of Form N–1A (17 CFR 274.11A), and Item 8 of Form N–2 (17 CFR 274.11a–1).

[72] When assessing the Year 2000 readiness of an external service provider that is a registered broker-dealer or transfer agent, the Year 2000 reports that are required to be submitted to us by most broker-dealers and transfer agents are one source of information.

[73] *See e.g.*, Item 4 of Form N–1A (17 CFR 274.11A), Item 8 of Form N–2 (17 CFR 274.11a–1).

[74] *See* Municipal Securities Interpretive Release, cited at note 6 above.

[75] Exchange Act Rule 15c2–12 (17 CFR 240.15c2–12).

[76] *See* Municipal Securities Interpretive Release.

will not be able to meet such obligations.

Issuers of general obligation debt may wish to consider, for example, the adverse effects, if any, Year 2000 issues may pose to their ability to assess and collect *ad valorem* taxes and allocate receipts and disbursements to proper funds in a timely manner to make debt service payments when due. In addition, while Year 2000 issues may not directly affect an issuer's ability to pay debt service, they may affect an issuer's general accounting and payment functions, which may be material to investors.

Revenue bond issuers may wish to consider, for example, any adverse effects Year 2000 issues may have on their ability to collect and administer the revenue stream securing their bonds and their ability to make timely payment of principal and interest on their obligations, as well as adverse effects to general accounting and payment functions, which may be material to investors.

Conduit borrowers, such as hospitals, universities and others, may wish to consider, for example, any adverse effects Year 2000 issues may have on their ability to deliver services, collect revenue and make timely payment on their obligations, including the obligation to pay debt service relating to municipal securities, which may be material to investors.

All issuers and conduit borrowers also may wish to consider the impact of Year 2000 problems facing third parties on their own ability to satisfy their responsibilities.

Other examples of suggested disclosure for consideration include, but are not limited to, the costs associated with fixing an issuer's Year 2000 problems, any loss associated with fixing an issuer's Year 2000 problems, any loss an issuer may incur because of Year 2000 problems, and any liabilities associated with an issuer's Year 2000 problems.

While not binding on issuers of municipal securities, issuers and persons assisting in preparing municipal issuer disclosure seeking further guidance may wish to review Sections III.A, B, and C of this release applicable to public companies.[77] The anti-fraud provisions of the federal securities law prohibit materially false and misleading statements or omissions, including those relating to the Year 2000 issues we have discussed in this release.

[77] *See also* Proposed Governmental Accounting Standards Board Technical Bulletin No. 98–a, ''Disclosures about Year 2000 Resources Committed,'' July 24, 1998. It can be found at <http://www.rutgers.edu/accounting/raw/gasb/gasbhome.html>.

List of Subjects

17 CFR Parts 231, 241, and 276

Securities.

17 CFR Part 271

Investment companies, Securities.

Amendments to the Code of Federal Regulations

For the reasons set forth in the preamble, the Commission is amending title 17, chapter II of the Code of Federal Regulations as follows:

PART 231—INTERPRETATIVE RELEASES RELATING TO THE SECURITIES ACT OF 1933 AND GENERAL RULES AND REGULATIONS THEREUNDER

1. Part 231 is amended by adding Release No. 33–7558 and the release date of July 29, 1998, to the list of interpretative releases.

PART 241—INTERPRETATIVE RELEASES RELATING TO THE SECURITIES EXCHANGE ACT OF 1934 AND GENERAL RULES AND REGULATIONS THEREUNDER

2. Part 241 is amended by adding Release No. 34–40277 and the release date of July 29, 1998, to the list of interpretative releases.

PART 271—INTERPRETATIVE RELEASES RELATING TO THE INVESTMENT COMPANY ACT OF 1940 AND GENERAL RULES AND REGULATIONS THEREUNDER

3. Part 271 is amended by adding Release No. IC–23366 and the release date of July 29, 1998, to the list of interpretative releases.

PART 276—INTERPRETATIVE RELEASES RELATING TO THE INVESTMENT ADVISERS ACT OF 1940 AND GENERAL RULES AND REGULATIONS THEREUNDER

4. Part 276 is amended by adding Release No. IA–1738 and the release date of July 29, 1998, to the list of interpretative releases.

Dated: July 29, 1998.

By the Commission.

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 98–20749 Filed 8–3–98; 8:45 am]

BILLING CODE 8010–01–U

SOCIAL SECURITY ADMINISTRATION

20 CFR Parts 404 and 416

[Regulations Nos. 4 and 16]

RIN 0960–AD73

Federal Old-Age, Survivors, and Disability Insurance and Supplemental Security Income for the Aged, Blind, and Disabled; Standards of Conduct for Claimant Representatives

AGENCY: Social Security Administration.

ACTION: Final rules.

SUMMARY: We are amending our rules governing representation of claimants seeking Social Security or supplemental security income (SSI) benefits under title II or XVI of the Social Security Act (the Act), as amended. The final rules establish standards of conduct and responsibility for persons serving as representatives and further define our expectations regarding their obligations to those they represent and to us. The final rules include statutorily and administratively imposed requirements and prohibitions.

EFFECTIVE DATE: This regulation is effective September 3, 1998.

FOR FURTHER INFORMATION CONTACT: Robert J. Augustine, Legal Assistant, Office of Process and Innovation Management, Social Security Administration, 6401 Security Boulevard, Baltimore, MD 21235, (410) 966–5121. For information on eligibility or claiming benefits, call our national toll-free number, 1–800–772–1213.

SUPPLEMENTARY INFORMATION:

Background

Prior regulations governing representatives' conduct (§§ 404.1740, *et seq.* and 416.1540, *et seq.*) under titles II and XVI, of the Act, primarily reiterate various statutory provisions set forth in the Act. Sections 404.1745 and 416.1545 also provide that a representative may be suspended or disqualified from practice before the Social Security Administration (SSA) if he or she has violated those rules, been convicted of a violation of sections 206 or 1631(d)(2) of the Act, respectively, or ''otherwise refused to comply with our rules and regulations on representing claimants in dealings with us.'' This is consistent with sections 206(a)(1) and 1631(d)(2) of the Act, which provide that the Commissioner of Social Security (the Commissioner) may ''suspend or prohibit from further practice before him any such person, agent, or attorney who refuses to comply with the Commissioner's rules and regulations * * *'' (Section 206(a)(1) is