

privately held enterprise where the operator of the business is also the source of much of the venture's financing. Legally mandated financial disclosure regimes for both unions and publicly held corporations are designed primarily to address a fundamental problem common to both institutions: that managerial control of an entity lies beyond the direct control of the people who fund the entity. *See generally* Henn & Alexander, *Hornbook on Laws of Corporations* § 186 *et seq.* (1983). Corporate and union financial disclosure regimes are intended to reduce the informational advantages agents have over principals and permit principals to monitor and assess the performance of agents. *See* Fletcher, *Cyclopedia of the Law of Private Corporations* §§ 2213 *et seq.*, 6842–43 (perm. ed.), available on Westlaw at Fletcher-CYC. Adequate transparency encourages union officers and corporate directors (agents) who are elected by union members and corporate shareholders (principals) to conduct the business of their organizations in the best interests of the people who provide the operating funds. Agents failing to do so can be removed through the mechanisms of corporate and union democracy. *See Cyclopedia of the Law of Private Corporations* § 351 *et seq.*

In a privately held enterprise, where the operator of the business is also the source of the venture's financing, there is no principal to perform the monitoring and no agent to be monitored. *See generally* *Laws of Corporations* § 257 *et seq.*; *see also* Soderquist, *Understanding the Securities Laws* § 2:2.2 (2001), available on Westlaw at PLIREF–SECLAW. While privately held companies are required to make certain financial disclosures related to franchise taxes, Small Business Administration loans, Federal Communications Commission licenses and other regulatory schemes, these disclosures are designed to assess taxes, fees, or eligibility for government-provided benefits, not to ensure transparency of managerial performance. *See generally* *Cyclopedia of the Law of Private Corporations* § 6666 *et seq.* The only scenario in which it is instructive to compare the financial disclosure regime of a privately held company to a union is when a privately held firm creates a principal/agent relationship by accepting funding through the venture capital markets. This scenario, however, also offers no basis for comparison with the relationship between a union and its members because financial institutions and other entities that provide such

funding can condition it on the disclosure of any financial information concerning the company seeking funding, can demand that the information be provided in any level of detail desired, and can use contractual remedies to enforce the condition. Union members, by contrast, are entitled only to the report that their union files with the Department of Labor pursuant to the LMRDA and, upon a showing of just cause, “to examine any books, records, and accounts necessary to verify such report.” 29 U.S.C. 431(b), (c).

Accordingly, the only reporting requirements applied to businesses that are relevant for comparison with the annual union financial report are those applied to publicly-traded companies. Generally speaking, the regulatory regime governing financial reporting by large and small public companies is much more extensive than the system that exists for labor organizations. *See generally* Hazen, *Law of Securities Regulation* §§ 3.2–3.7, 9.4 (2002), available on Westlaw at LAWSECREG; *Understanding the Securities Laws* § 2:2.2. Furthermore, the reporting requirements under the securities laws have been substantially increased since the enactment of the Sarbanes-Oxley Act, Pub. L. 107–204, 116 Stat. 745. *See generally* 68 FR 36636–01 *et seq.* (June 18, 2003) (amending various disclosure rules established by the Securities and Exchange Commission (“SEC”), including 17 CFR 240.13a–14, 240.13a–15, 240.15d–14, 240.15d–15, 249.220f). Labor organizations must file only one form a year, need not disclose qualitative information, and are not required to conduct certified audits of their financial statements. *See* 29 U.S.C. 431. The financial reporting scheme for public companies, as amended by the Sarbanes-Oxley Act, requires the disclosure of both quantitative and qualitative information and imposes strict audits and significant internal controls on public companies, their officers, directors, auditors, accountants and attorneys. *See generally* 17 CFR Parts 210–211, 228–32, 239, 241, 249 (Subparts A–D) (2003) (particularly provisions amended by 68 FR 4820 (Jan. 30, 2003), 68 FR 5110 (Jan. 31, 2003), 68 FR 15354–02 (Mar. 31, 2003), 68 FR 36636–01 (June 18, 2003)). *See also* Bloomenthal, *Sarbanes-Oxley Act in Perspective* § 10 (2002), available on Westlaw at SEC–SOAP S 10. Small and large public companies are required to file annual and quarterly reports. *See* 17 CFR 240.13a–1 *et seq.*; *Cyclopedia of the Law of Private Corporations* § 6842; *Law of Securities Regulation* § 9.6[4]. All

public companies must certify audits for the accuracy of information in their annual and quarterly reports. *See* 68 FR 36636 *et seq.* (discussed above); Bloomenthal & Wolff, *Securities and Federal Corporate Law* § 7:35.13 (2002). A substantial amount of quantitative financial information is contained in both annual and quarterly reports. These reports must disclose “material” financial information. *See Law of Securities Regulation* §§ 3.2–3.7, 9.4; *Understanding the Securities Laws* § 12–8; *Cyclopedia of the Law of Private Corporations* § 6862. In its Statement of Financial Accounting Concepts No. 2 (SFAC No. 2), the Financial Accounting Standards Board (FASB) stated the essence of the concept of materiality as follows:

The omission or misstatement of an item in a financial report is material if, in the light of surrounding circumstances, the magnitude of the item is such that it is probable that the judgment of a reasonable person relying upon the report would have been changed or influenced by the inclusion or correction of the item.

*Id.* at ¶ 132. *See* discussion below in Section (II)(D). Due to the myriad factors involved in determining whether financial information meets this rather vague threshold, professional assistance is required. *See id.* at ¶¶ 123–132. As noted above, the SEC generally requires public companies to disclose in their annual reports “material” quantitative information on balance sheets or income statements related to numerous types of assets, accounts, and expenditures. *See Law of Securities Regulation* §§ 3.2–3.7, 9.4. Public companies must disclose “material” financial data on executive compensation, including: annual salary; bonuses; other annual compensation; restricted stock; and options. *Id.* They must also provide “material” quantitative information on computation of per share earnings and market risk. *Id.* The Sarbanes-Oxley Act added several additional categories of material, quantitative data that public companies must disclose, including disclosing in each annual and quarterly report all “material” off-balance sheet transactions, arrangements and obligations (including contingent obligations). *See* Title III, 116 Stat. 775, and Title IV, 116 Stat. 785.

Since its inception, the LM–2 reporting system has eschewed the use of a vague standard based on individualized judgments regarding materiality for determining what quantitative data a union must report, and has instead required specific information regarding all assets, liabilities and transactions. The Department has determined that it will