

1 Amend 2 Cal. Code Regs. Section 18705.1.

2 **§ 18705.1. Materiality Standard: Economic Financial Interest in Business Entities.**

3 ~~(a) Introduction.~~

4 ~~(1) If a business entity in which a public official has an economic interest is directly~~
5 ~~involved in a governmental decision (see Regulation 18704.1(a)), use the standards in~~
6 ~~subdivision (b) of this regulation.~~

7 ~~(2) If a business entity in which a public official has an economic interest is indirectly~~
8 ~~involved in a governmental decision (see Regulation 18704.1(b)), use the standards in~~
9 ~~subdivision (c) of this regulation.~~

10 ~~(b) Directly involved business entities.~~

11 ~~(1) General Rule: Unless the exception in subdivision (b)(2) of this regulation applies, the~~
12 ~~financial effects of a governmental decision on a business entity which is directly involved in the~~
13 ~~governmental decision is presumed to be material. This presumption may be rebutted by proof~~
14 ~~that it is not reasonably foreseeable that the governmental decision will have any financial effect~~
15 ~~on the business entity.~~

16 ~~(2) Exception: If the public official's only economic interest in the business entity is an~~
17 ~~investment interest (see Section 87103(a)), and the public official's investment in the business~~
18 ~~entity is worth \$25,000 or less, apply the materiality standards in either of the following~~
19 ~~provisions, as applicable:~~

20 ~~(A) Subdivision (c)(1) of this regulation if the business entity is listed in the Fortune 500,~~
21 ~~or if not listed in the Fortune 500, has revenues that are no less than the revenues of the business~~
22 ~~entity that ranks 500th in the Fortune 500 list.~~

23 ~~(B) Subdivision (c)(2) of this regulation if the business entity is listed on the New York~~
24 ~~Stock Exchange, or if not listed on the New York Stock Exchange, for its most recent fiscal year~~
25 ~~had net income of no less than \$2.5 million.~~

26 ~~(c) Indirectly involved business entities. The following materiality standards apply when~~
27 ~~a business entity in which a public official has an economic interest is indirectly involved in a~~

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1 governmental decision. If more than one of the following subdivisions is applicable to the
2 business entity in question, apply the subdivision with the highest dollar thresholds.

3 ~~(1) If the business entity is listed in the Fortune 500 or, if not listed in the Fortune 500,~~
4 ~~has revenues that are no less than the revenues of the business entity that ranks 500th in the~~
5 ~~Fortune 500 list, the financial effect of a governmental decision on the business entity is material~~
6 ~~if it is reasonably foreseeable that:~~

7 ~~(A) The governmental decision will result in an increase or decrease in the business~~
8 ~~entity's gross revenues for a fiscal year of \$10,000,000 or more; or~~

9 ~~(B) The governmental decision will result in the business entity incurring or avoiding~~
10 ~~additional expenses or reducing or eliminating existing expenses for a fiscal year in the amount~~
11 ~~of \$2,500,000 or more; or~~

12 ~~(C) The governmental decision will result in an increase or decrease in the value of the~~
13 ~~business entity's assets or liabilities of \$10,000,000 or more.~~

14 ~~(2) If the business entity is listed on the New York Stock Exchange, or if not listed on the~~
15 ~~New York Stock Exchange, for its most recent fiscal year had net income of no less than \$2.5~~
16 ~~million, the financial effect of a governmental decision on the business entity is material if it is~~
17 ~~reasonably foreseeable that:~~

18 ~~(A) The governmental decision will result in an increase or decrease to the business~~
19 ~~entity's gross revenues for a fiscal year in the amount of \$500,000 or more; or,~~

20 ~~(B) The governmental decision will result in the business entity incurring or avoiding~~
21 ~~additional expenses or reducing or eliminating existing expenses for a fiscal year in the amount~~
22 ~~of \$200,000 or more; or,~~

23 ~~(C) The governmental decision will result in an increase or decrease in the value of assets~~
24 ~~or liabilities of \$500,000 or more.~~

25 ~~(3) If the business entity is listed on either the NASDAQ or American Stock Exchange,~~
26 ~~or if not so listed, for its most recent fiscal year had net income of no less than \$750,000, the~~
27 ~~financial effect of a governmental decision on the business entity is material if it is reasonably~~
28 ~~foreseeable that:~~

1 (A) ~~The governmental decision will result in an increase or decrease to the business~~
2 ~~entity's gross revenues for a fiscal year in the amount of \$300,000 or more; or,~~

3 (B) ~~The governmental decision will result in the business entity incurring or avoiding~~
4 ~~additional expenses or reducing or eliminating existing expenses for a fiscal year in the amount~~
5 ~~of \$100,000 or more; or,~~

6 (C) ~~The governmental decision will result in an increase or decrease in the value of assets~~
7 ~~or liabilities of \$300,000 or more.~~

8 (4) ~~If the business entity is not covered by subdivisions (c)(1)-(3), the financial effect of a~~
9 ~~governmental decision on the business entity is material if it is reasonably foreseeable that:~~

10 (A) ~~The governmental decision will result in an increase or decrease in the business~~
11 ~~entity's gross revenues for a fiscal year in the amount of \$20,000 or more; or,~~

12 (B) ~~The governmental decision will result in the business entity incurring or avoiding~~
13 ~~additional expenses or reducing or eliminating existing expenses for a fiscal year in the amount~~
14 ~~of \$5,000 or more; or,~~

15 (C) ~~The governmental decision will result in an increase or decrease in the value of the~~
16 ~~business entity's assets or liabilities of \$20,000 or more.~~

17 (d) ~~Terminology. The accounting terms described below are the same as, or not~~
18 ~~inconsistent with, terms used in Generally Accepted Accounting Principles and Generally~~
19 ~~Accepted Auditing Standards. Nothing in this subdivision should be construed to incorporate~~
20 ~~new items not contemplated under Generally Accepted Accounting Principles and Generally~~
21 ~~Accepted Auditing Standards, nor to exclude any items that might be included in the definitions~~
22 ~~of these terms under Generally Accepted Accounting Principles and Generally Accepted~~
23 ~~Auditing Standards~~

24 (1) ~~Assets. As used in this section, "assets" means all property, real and personal, tangible~~
25 ~~and intangible, which belongs to any business entity. This includes, but is not limited to, cash,~~
26 ~~securities, merchandise, raw materials, finished goods, operating supplies, and ordinary~~
27 ~~maintenance material and parts, accounts receivable and notes and loans receivable, and prepaid~~
28 ~~expenses (such as prepaid insurance, interests, rents, taxes, advertising, and operating supplies).~~

1 (A) ~~When a business entity holds a claim over collateral (including real property) as~~
2 ~~security for a loan made by the business entity, such a claim does not make the collateral~~
3 ~~(including real property) an "asset" of the business entity, unless the business entity has initiated~~
4 ~~proceedings to foreclose upon, or acquire the asset based on the debtor's failure to repay the loan.~~
5 ~~The loan or note secured by the collateral is an asset.~~

6 (B) ~~The definition of "assets" also includes intangible assets. Intangible assets, include,~~
7 ~~but are not limited to, long-lived legal rights and competitive advantages developed or acquired~~
8 ~~by a business enterprise, patents, copyrights, franchises, trademarks, organizational costs,~~
9 ~~goodwill, and secret processes.~~

10 (2) ~~Expenses: In general, the term refers to the current costs of carrying on an activity.~~

11 (3) ~~Gross Revenue. Actual or expected inflows of cash or other assets. "Gross Revenue"~~
12 ~~is the revenue of a business entity before adjustments or deductions are made for returns and~~
13 ~~allowances and the costs of goods sold, and prior to any deduction for these and any other~~
14 ~~expenses.~~

15 (4) ~~Liabilities: Obligations of the business entity, liquidation of which is reasonably~~
16 ~~expected to require the transfer of assets or the creation of other new liabilities. Any financial~~
17 ~~obligation or cash expenditures that must be made by the business entity at a specific time to~~
18 ~~satisfy the contractual terms of such an obligation.~~

19 (5) ~~Net Income: A business entity's total earnings; otherwise defined as revenues~~
20 ~~adjusted for the costs of doing business, depreciation, interest, taxes, and other expenses. This~~
21 ~~amount is usually found at the bottom of a business entity's Profit and Loss statement. Also~~
22 ~~described as Net Profit.~~

23 (e) ~~Financial Statements. In complying with this regulation, public officials may rely on~~
24 ~~the most recent independently audited financial statements of the business entity so long as those~~
25 ~~statements are reflective of the current condition of the business entity. Financial statements are~~
26 ~~not considered "reflective of the current condition of the business entity" where:~~

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1 (1) The most recent independently audited financial statements of the business entity are
2 for a fiscal year ending more than twenty-four months prior to the date of the governmental
3 decision.

4 (2) The most recent audit of the financial statements resulted in an adverse opinion, was
5 issued with a disclaimer, or was otherwise qualified in such a manner that the statement of assets,
6 liabilities, expenses, or gross revenues is questioned in the audit report, or

7 (3) There has been a subsequent event, intervening between the date that the financial
8 statement was created and the date of the decision of the public official, that makes the statement
9 no longer representative, including, but not limited to, business reorganizations.

10 Comments: Electronic access to annual reports, quarterly reports, and other financial
11 statements filed with the United States Securities and Exchange Commission ("SEC") may be
12 obtained by accessing the SEC's website and selecting its EDGAR database of statutory filings:
13 [http:// www.sec.gov/edgar/searchedgar/companysearch.html](http://www.sec.gov/edgar/searchedgar/companysearch.html).

14 (a) The reasonably foreseeable financial effect of a governmental decision on a business
15 entity in which an official has a financial interest identified in Section 87103(a) or (d) is material
16 whenever the business entity:

17 (1) Initiates the proceeding in which the governmental decision will be made by filing an
18 application, claim, appeal, or request for other government action concerning the business entity;

19 (2) Offers to make a sale of a service or a product to the official's agency;

20 (3) Bids on or enters into a written contract with the official's agency;

21 (4) Is the named manufacturer in a purchase order of any product purchased by the
22 official's agency or the sales provider of any products to the official's agency that aggregates to
23 \$1,000 or more in any 12-month period;

24 (5) Applies for a permit, license, grant, tax credit, exception, variance, or other
25 entitlement that the official's agency is authorized to issue;

26 (6) Is the subject of any inspection, action, or proceeding subject to the regulatory
27 authority of the official's agency; or

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1 (7) Is otherwise subject to an action taken by the official's agency, the effect of which is
2 directed solely at the business entity in which the official has an interest.

3 (8) Exception. Notwithstanding the above provisions, any financial effect on a business
4 entity that occurs as a result of a travel payment made for food, lodging, transportation, or fuel,
5 authorized by an agency in the course of carrying out an agency function, to a business entity
6 that provides such services to the general public shall be treated under subdivision (b).

7 (b) For a governmental decision not identified in subdivision (a), the financial effect is
8 material if a prudent person with sufficient information would find it is reasonably
9 foreseeable that the decision's financial effect would contribute to a change in the price of the
10 business entity's publicly traded stock, or the value of a privately-held business entity. Examples
11 of decisions that may be applicable include those that:

12 (1) Authorize, prohibit, regulate or otherwise establish conditions for an activity in which
13 the business entity is engaged;

14 (2) Increase or decrease the amount of competition in the field in which the business
15 entity is engaged;

16 (3) Increase or decrease the need for the products or services that the business entity
17 supplies;

18 (4) Make improvements in the surrounding neighborhood such as redevelopment
19 projects, traffic/road improvements, or parking changes that may affect, either temporarily or
20 permanently, the amount of business the business entity receives;

21 (5) Decide the location of a major development, entertainment facility, or other project
22 that would increase or decrease the amount of business the entity draws from the location of the
23 project; or

24 (6) Increase or decrease the tax burden, debt, or financial or legal liability of the business
25 entity.

26 Note: Authority cited: Section 83112, Government Code. Reference: Sections 87100, 87102.5,
27 87102.6, 87102.8 and 87103, Government Code.

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