

REQUEST FOR COMMISSION ACTION

Control No.: S-02-90-00

Management's Discussion and Analysis
substantially in the form of Attachment A to
with respect to MD&A

DETERMINED TO BE AN
ADMINISTRATIVE MARKING
E.O. 12065, Section 8-103
By *JMV* NARS, Date *5/2/2013*

Decision on this matter is
the provisions

ACTION MEMORANDUM

January 16, 2002

TO: The Commission
FROM: Office of the Chief Accountant *AK*
SUBJECT: Commission Statement Regarding MD&A

RECOMMENDATION: That the Commission publish a statement substantially in the form of Attachment A to suggest steps that issuers should consider in meeting their disclosure obligations with respect to MD&A while preparing year-end and interim financial reports and disclosures in other filings made after the issuance of this release, and to ask for comment on future possible rulemaking.

ACTION REQUESTED BY: January 17, 2002

SUNSHINE ACT STATUS: Seriatim

REGULATORY FLEXIBILITY ACT STATUS: Not applicable.

PAPERWORK REDUCTION ACT STATUS: Not applicable.

NOVEL, IMPORTANT OR COMPLEX ISSUES: Explanation of risks and uncertainties surrounding (a) off balance sheet financing structures, (b) trading activities involving non-exchange traded contracts accounted for at fair value, and (c) the effects of transactions with related and certain other parties.

OTHER OFFICES OR DIVISIONS CONSULTED: Office of the General Counsel (David Fredrickson)
Division of Corporation Finance (Martin Dunn)
Division of Investment Management (Dave Smith)
Division of Enforcement (Steve Cutler)

PRIOR COMMISSION ACTION: None.

LOUF

UNCLASSIFIED
33-8056
1/2

REQUEST FOR COMMISSION ACTION

Control No.:

S-02-90-

DETERMINED TO BE AN
ADMINISTRATIVE MARKING
E.O. 12065, Section 6-103
By JMV NARS, Date 5/2/2012

EST

PERSONS TO CONSULT: Office of the Chief Accountant
Robert Herdman x4400
Robert Bayless x2892
Robert Burns x4425

I. Background

On December 31, 2001, the Commission received a petition from the accounting firms of Arthur Andersen LLP, Deloitte and Touche LLP, Ernst & Young LLP, KPMG LLP, and PricewaterhouseCoopers LLP. The petition, which was endorsed by the American Institute of Certified Public Accountants, requested that the Commission issue additional interpretive guidance regarding Item 303 of Regulation S-K, *Management's Discussion and Analysis of Financial Condition and Results of Operations*,¹ Item 303 of Regulation S-B, *Management's Discussion and Analysis of Plan of Operations*,² and Item 5 of Form 20-F, *Operating and Financial Review and Prospects*³ (collectively, "MD&A" or "the MD&A rules"). The petitioners requested that this additional guidance be provided to public companies quickly as they are currently preparing their annual reports for the fiscal year just ended, and attached a proposed interpretive release.

- The petition identified three areas of concern with regard to MD&A disclosure:
- liquidity and capital resources, including off-balance sheet arrangements;
 - certain trading activities involving non-exchange traded contracts accounted for at fair value; and
 - relationships and transactions with persons or entities that derive benefits from their non-independent relationship with the registrant or the registrant's related parties.

The petition is one of several actions contemplated by the accounting firms in their joint press release of December 4, 2001 responding to the demise of Enron Corporation. The petitioners indicated that, following issuance by the Commission of the recommended interpretive guidance, they expect to petition the Commission to adopt new rules to establish minimum disclosure requirements for the three areas identified in the petition. The firms indicated that the objective of that rulemaking would be to promote more consistent and comparable disclosure by registrants.

II. Discussion of Petition and Possible Commission Actions

Generally, the staff agree that the petitioners have identified areas of financial and operating risk that warrant disclosure that is completely responsive to the Commission rules, and that is presented in a clear and understandable style and format. The petitioners'

¹ 17 CFR 229.303.

² 17 CFR 228.303.

³ See 17 CFR 249.220f.

33-80-112210
REQUEST FOR COMMISSION ACTIONControl No.: S-02-90-1
Discussion and Analysis

Attachment A to SU

DETERMINED TO BE AN
ADMINISTRATIVE MARKING
E.O. 12065, Section 6-108
By JMV NARS, Date 5/2/2013

recommendaions appear to be thoughtful and constructive. However, the staff is not recommending that the Commission issue an interpretation of the MD&A rules at this time. Instead, the staff is recommending that the Commission issue a statement suggesting steps registrants should consider in meeting their obligations regarding MD&A, and soliciting public comment on those steps and the petition. We recommend further that the Commission statement be followed before May 30th, 60 days after 2001 annual reports have been filed, by a rule proposal that would elicit more targeted disclosure that could better achieve consistency and comparability in the three important areas identified by the petitioners.

Many of the recommended disclosures are already required by the MD&A rules. Some of the recommended disclosures are required by the MD&A rules only in particular circumstances, and would not be expected in filings more generally. Other recommendations may be characterized as "best practice," eliciting detailed disclosure that may be beyond the present requirements of MD&A. The staff believes the disclosures would be very useful to investors. Disclosure in current filings would likely improve if the Commission issued a statement at this time, when a majority of public companies are preparing their 2001 annual reports.

However, the staff cannot complete so quickly a review of the petition that distinguishes between those recommended disclosures that are legally required by existing securities laws and regulations and any that are not. In addition, terms used in the petition to identify the off-balance sheet structures, commodity trading activities, and related parties within the scope of the guidance appear to require crisper definition to be fully effective. Development of useful definitions will not be easy. Further, the staff recognizes that the Commission's articulation of any interpretation of long-standing MD&A rules must be carefully drawn because of its implications for possible enforcement actions against companies that did not observe that interpretation in their disclosure prior to publication of the interpretation.

The course of action recommended by the staff in this memorandum – to issue a statement, rather than an interpretation – is intended to accomplish the key objective of drawing attention to the recommendations so that they will be considered by public companies, while allowing Commission resources to focus directly on developing substantive improvements to the Commission's disclosure rules in the three identified areas. The purpose of the draft statement in Attachment A is to suggest useful steps that issuers should consider in meeting their disclosure obligations. This draft statement explicitly disclaims creating new legal requirements, or making any comment on any disclosure that already is or is not required by existing rules. The statement also alerts the public to the Commission's intention to further address these areas of important disclosure, and invites comment generally on the petitioners' recommendations and the Commission's statement.

The Commission has received one comment letter on the firms' petition.⁴ That commenter, Dynegy Inc., applauded the "proactive efforts" of the firms and plans to expand its

⁴ Letter to Jonathan G. Katz, Secretary, Securities and Exchange Commission, from Robert D. Doty, Executive Vice President, and Michael R. Mott, Senior Vice President, Dynegy Inc., dated January 8, 2002.

PRIVILEGED & CONFIDENTIAL
33-8056
1/22

DETERMINED TO BE AN
ADMINISTRATIVE MARKING
E.O. 12065, Section 6-103
By *JMV* NARS, Date *5/2/2013*

REQUEST FOR COMMISSION ACTION

Control No.:

S-02-90-C

1-11-13

existing disclosures "to meet the granularity desired by this proposal." However, Dynegy asked that the disclosure requirement regarding non-exchange traded contracts accounted for at fair value eliminate references specific to any industry, or require all enterprises engaged in the merchant energy industry provide the disclosure, regardless of the significance of those operations. In a follow-up conversation with the staff, Dynegy representatives acknowledged the absence of a trading market providing yields on energy contracts with terms beyond 10 years, and could not readily identify other financial trading activities that faced a similar handicap to estimating fair values of long-term contracts.

III. Recommendation

For the reasons discussed above, the Office of the Chief Accountant recommends that the Commission issue the attached statement.