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SEC ISSUES STATEMENT REGARDING MD&A DISCLOSURE

The SEC has issued a statement setting forth certain views regarding disclosure that should be considered by registrants as they prepare their *Management's Discussion and Analysis of Financial Condition and Results of Operations* ("MD&A") for their annual and quarterly SEC reports. The statement was issued in response to a December petition from the "big five" accounting firms, which was endorsed by the AICPA, that the SEC issue additional guidance on MD&A disclosure.

The statement focuses on the following three areas of 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
- transactions with related and certain other parties.

The statement is not intended by the SEC to create new legal requirements or modify existing requirements. Rather, it is an attempt to clarify existing disclosure requirements. Rulemaking regarding the topics addressed in the statement and other aspects of MD&A disclosure is expected to be released at a later date.

Disclosures Concerning Liquidity and Capital Resources, Including "Off-Balance Sheet" Arrangements.

1. Liquidity and Capital Resources.

The SEC reiterated that disclosure of liquidity and capital resources should not be overly general and should encompass internal and external sources, current conditions as well as future commitments and known trends, changes in circumstances and uncertainties. In particular, disclosure should include the sources of short-term funding and the circumstances or material risks that are *reasonably likely* to affect those sources of liquidity. These circumstances or risks could include market price changes, economic downturns, defaults on guarantees or contraction of operations that have material consequences for a registrant's

1285 Avenue of the Americas
New York, New York 10019-6064
(212) 373-3000

1615 L Street, NW
Washington, DC 20036-5694
(202) 223-7300

Alder Castle, 10 Noble Street
London EC2V 7JU England
(44-20) 7367 1600

2, rue du Faubourg Saint-Honoré
75008 Paris, France
(33-1) 53.43.14.14

Fukoku Seimei Building 2nd Floor
2-2, Uchisawaicho 2-chome
Chiyoda-ku, Tokyo 100, Japan
(81-3) 3597-8120

2918 China World Tower II
No. 1, Jianguomenwai Dajie
Beijing 100004, People's Republic of China
(86-10) 6505-6822

12th Fl., Hong Kong Club Building
3A Chater Road, Central
Hong Kong
(852) 2536-9933

financial position or operating results. Material effects on liquidity as a result of any such “reasonably likely” events should be disclosed.

For example, if a registrant’s principal source of liquidity is operating cash flow, it may need to disclose the extent of the risk that a decrease in demand for its products would reduce the availability of funds. If commercial paper is a principal source of liquidity, the registrant may need to disclose how this facility could be adversely affected by a debt rating downgrade or deterioration in certain of its financial ratios or other measures of financial performance. If a registrant’s liquidity is dependent on the use of “off-balance sheet” financing arrangements (e.g., securitization of receivables or access to assets through special purpose entities), it may need to disclose the factors that are reasonably likely to affect its ability to continue using those off-balance sheet financing arrangements.

To identify trends, demands, commitments, events and uncertainties that management must assess under SEC interpretations of the MD&A disclosure rules, management needs to consider the following:

- provisions in financial guarantees or commitments, debt or lease agreements or other arrangements that could trigger a requirement for an early payment, additional collateral support, changes in terms, acceleration of maturity, or the creation of an additional financial obligation (e.g., adverse changes in credit rating, financial ratios, earnings, cash flows or stock price or changes in the value of underlying, linked or indexed assets);
- circumstances that could impair the registrant's ability to continue to engage in transactions that have been integral to its historical operations or are financially or operationally essential, or that could render that activity commercially impracticable (e.g., inability to maintain a specified investment grade credit rating, level of earnings, earnings per share, financial ratios or collateral);
- factors specific to the registrant and its markets that the registrant expects to be given significant weight in the determination of its credit rating or will otherwise affect its ability to raise short-term and long-term financing;
- guarantees of debt or other commitments to third parties; and
- written options on non-financial assets (e.g., real estate puts).

2. Off-Balance Sheet Arrangements.

Registrants need to consider the need to provide disclosures concerning transactions, arrangements and other relationships with unconsolidated entities (e.g., structured finance or special purpose entities) or other persons that are reasonably likely to affect materially their liquidity or the availability of, or requirements for, capital resources. The extent of a registrant’s reliance on off-balance sheet arrangements should be described fully and clearly where the special purpose entities provide financing, liquidity, or market or credit risk support for the registrant; engage in leasing, hedging, research and development services with the registrant; or expose the registrant to liability that is not reflected on the face of the financial statements. Where contingencies inherent in the arrangements are reasonably likely to affect the continued availability of a material historical source of liquidity and finance,

registrants must disclose those uncertainties and their effects. While legal opinions regarding "true sale" issues or other issues relating to whether a registrant has contingent, residual or other liability can play an important role in transactions involving such entities, they do not obviate the need for a registrant to consider whether disclosure is required.

Registrants need to consider disclosing the following with respect to their off-balance sheet arrangements: their business purposes and activities; their economic substance; the key terms and conditions of any commitments; the initial and ongoing relationships with the registrant and its affiliates; and the registrant's potential risk exposures resulting from its contractual or other commitments involving the off-balance sheet arrangements. Other disclosures that registrants need to consider to explain the effects and risks of off-balance sheet arrangements include:

- the total amount of assets and obligations of the off-balance sheet entity, with a description of the nature of its assets and obligations, and identification of the class and amount of any debt or equity securities issued by the registrant;
- the effects of the entity's termination if it has a finite life or it is reasonably likely that the registrant's arrangements with the entity may be discontinued in the foreseeable future;
- the amounts receivable or payable, and revenues, expenses and cash flows resulting from the arrangements;
- the extended payment terms of receivables, loans and debt securities resulting from the arrangements, and any uncertainties as to realization, including any repayment that is contingent upon the future operations or performance of any party;
- the amounts and key terms and conditions of purchase and sale agreements between the registrant and the counterparties in any such arrangements; and
- the amounts of any guarantees, lines of credit, standby letters of credit or commitments or take or pay contracts, throughput contracts or other similar types of arrangements, including tolling, capacity or leasing arrangements, that could require the registrant to provide funding of any obligations under the arrangements, including guarantees of repayment of obligors of parties to the arrangements, make whole agreements, or value guarantees.

In addition, the SEC cautioned registrants that disclosure of these matters should be clear and individually tailored to describe the risks to the registrant and should not consist merely of recitation of the transactions' legal terms or the relationships between the parties or similar boilerplate.

3. Contractual Obligations and Commercial Commitments.

The SEC recommended that registrants present aggregated information about their contractual obligations and commercial commitments in a single location in the MD&A. Commercial commitments include lines of credit, guarantees and other potential cash outflows resulting from a contingent event that requires the registrant to perform pursuant to

a funding commitment. This information could be provided as a schedule of contractual obligations and commercial commitments as of the latest balance sheet date. The suggested format of such schedule is provided in Annex A to this memorandum.

Disclosures Concerning Certain Trading Activities that Include Non-Exchange Traded Contracts Accounted for at Fair Value.

Registrants engaged to a material extent in trading activities involving commodity contracts that are accounted for at fair value but for which a lack of market price quotations necessitates the use of fair value estimation techniques need to consider providing disclosures in the MD&A that supplement those required by applicable accounting standards (e.g., additional statistical information about these business activities and transactions). This additional information should also cover contracts that are derivatives involving the same commodities that are part of those trading activities.

A discussion in the MD&A of material trends and uncertainties arising from material energy trading and risk management activities is also required. This discussion is in addition to the disclosures already required pursuant to accounting standards. Information about these trading activities, contracts and modeling methodologies, assumptions, variables and inputs, along with explanations of the different outcomes reasonably likely under different circumstances or measurement methods, should be considered for inclusion in management's discussion of how these activities affect reported results for the latest annual period and subsequent interim period and how a registrant's financial position is affected as of its latest balance sheet date.

The SEC recently issued cautionary advice encouraging registrants to include in their MD&A full explanations, in plain English, of their "critical accounting policies," the judgments and uncertainties affecting the application of those policies and the likelihood that materially different amounts would be reported under different conditions or using different assumptions. Consistent with that advice, registrants need to consider providing information, quantified to the extent practicable, that:

- disaggregates realized and unrealized changes in fair value;
- identifies changes in fair value attributable to changes in valuation techniques;
- disaggregates estimated fair values at the latest balance sheet date based on whether fair values are determined directly from quoted market prices or are estimated; and
- indicates the maturities of contracts at the latest balance sheet date (e.g., within one year, within years one through three, within years four and five, and after five years).

The suggested format for such disclosure is provided in Annex B to this memorandum.

In addition, registrants may need to disclose the fair value of net claims against counterparties that are reported as assets at the most recent balance sheet date, based on the credit quality of the contract counterparty (e.g., investment grade; non-investment grade; and no external ratings).

Registrants also need to consider their disclosure obligations regarding risk management in connection with the trading activities discussed above. Registrants should consider whether they should provide fuller disclosure regarding the management of risks related to, for example, changes in credit quality or market fluctuations of underlying, linked or indexed assets or liabilities, especially where such assets are illiquid or susceptible to material uncertainties in valuation.

Disclosures Concerning the Effects of Transactions with Related and Certain Other Parties.

Where related party transactions are material, registrants need to include a discussion of these transactions in their MD&A (in addition to the currently required disclosures under Item 404 of Regulation S-K or Regulation S-B) to the extent necessary for an understanding of their current and prospective financial position and operating results. The SEC also noted that audit committees may also wish to include a review of these relationships and transactions in their discussions with management and auditors, including a review of their terms and internal corporate and Board actions involving these transactions, prior to their recommendation that the annual financial statements be included in the Form 10-K.

The disclosure should include the elements of the transaction that are necessary for an understanding of the transactions' business purpose and economic substance, their effects on the financial statements and the special risks or contingencies arising from these transactions. The disclosure should also include:

- the identity of the related parties transacting business with the registrant;
- how the transaction prices were determined by the parties;
- where transactions have been evaluated for fairness, a description of how the evaluation was made; and
- any ongoing contractual or other commitments as a result of the arrangement.

Registrants also need to consider providing disclosures about parties that fall outside the definition of "related parties" but with whom they or their related parties have a relationship that enables these outside parties to negotiate terms of material transactions that may not be available from other, more clearly independent, parties on an arm's-length basis (e.g., transactions with entities established or operated by former members of management or which have former relationships with the registrant).

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This memorandum provides only a general overview of the SEC's statement regarding MD&A disclosure. It is not intended to provide or constitute legal advice, and no legal or business decision should be based on its contents. Any questions concerning the foregoing should be addressed to members of the Paul Weiss Securities Group (see below). In addition, memoranda on related topics may be accessed under Securities Group publications on our web site (www.paulweiss.com).

Mark S. Bergman	(44 20) 7367 1601	Paul D. Ginsberg	(1) 212-373-3131
Richard S. Borisoff	(1) 212-373-3153	John C. Kennedy	(1) 212-373-3025
Valérie Demont	(1) 212-373-3076	Edwin S. Maynard	(1) 212-373-3024
Andrew J. Foley	(1) 212-373-3078		

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Annex A

Contractual Obligations	Payments Due by Period				
	Total	Less than 1 year	1-3 years	4 - 5 years	After 5 years
Long-Term Debt					
Capital Lease Obligations					
Operating Leases					
Unconditional Purchase Obligations					
Other Long-Term Obligations					
Total Contractual Cash Obligations					

The preceding table could be accompanied by footnotes to describe provisions that create, increase or accelerate liabilities, or other pertinent data.

Other Commercial Commitments	Total Amounts Committed	Amount of Commitment Expiration Per Period			
		Less than 1 year	1 - 3 years	4 - 5 years	Over 5 years
Lines of Credit					
Standby Letters of Credit					
Guarantees					
Standby Repurchase Obligations					
Other Commercial Commitments					
Total Commercial Commitments					

Annex B

Fair value of contracts outstanding at the beginning of the period	XXXX
Contracts realized or otherwise settled during the period	XXXX
Fair value of new contracts when entered into during the period	XXXX
Changes in fair values attributable to changes in valuation techniques and assumptions	XXXX
Other changes in fair values	XXXX
Fair value of contracts outstanding at the end of the period	XXXX

Source of Fair Value	Fair Value of Contracts at Period-End				
	Maturity less than 1 year	Maturity 1 - 3 years	Maturity 4 - 5 years	Maturity in excess of 5 years	Total fair value
Prices actively quoted					
Prices provided by other external sources					
Prices based on models and other valuation methods					