

**SEC ISSUES RELEASES  
CONCERNING MD&A AND OTHER  
ACCOUNTING-RELATED DISCLOSURES**

JANUARY 30, 2002

The Securities and Exchange Commission ("SEC"), in the aftermath of the collapse of Enron Corporation, recently issued two releases regarding management's discussion and analysis ("MD&A") and other accounting-related disclosures by public companies in their filings under the Securities Act of 1933, as amended (the "Securities Act"), and the Securities Exchange Act of 1934, as amended (the "Exchange Act"). The first release (Release Nos. 33-8040; 34-45149) was issued on December 12, 2001 and is entitled "Cautionary Advice Regarding Disclosure About Critical Accounting Policies" (which we refer to herein as the "*Cautionary Advice Release*"). The second release (Release Nos. 33-8048; 34-45189) was issued on January 22, 2002 and is entitled "Commission Statement About Management's Discussion and Analysis of Financial Condition and Results of Operations" (which we refer to herein as the "*MD&A Release*"). Both releases urge public companies to use particular care in the preparation of MD&A and other accounting-related disclosures in upcoming filings. The MD&A Release also provides guidance with respect to the preparation of specific MD&A disclosure items that have been implicated in the Enron context.

The Cautionary Advice Release directs each public company to analyze closely, and to present with precision, critical accounting policies applied by it and to include in its MD&A a "plain English" explanation of such policies as well as of key judgments and assumptions made in applying such policies in its financial presentation. The SEC notes that investors "may lose confidence in a company's management and financial statements if sudden changes in its financial condition and results occur, but were not preceded by disclosures about the susceptibility of reported amounts to change, including rapid change." The SEC urges each public company and its auditors and other advisors to take the following steps:

- to bring particular focus to the evaluation of critical accounting policies used in the financial statements;
- to ensure that MD&A disclosures are balanced and comprehensive;
- to ensure that the audit committee reviews the selection, application and disclosure of critical accounting policies; and
- to consult with the SEC's accounting staff as to any uncertainties concerning the application of specific GAAP principles.

The Cautionary Advice Release does not, in our view, impose any new specific requirements for public companies, but rather exhorts public companies and their auditors and advisors to prepare and analyze MD&A and other accounting-related disclosures from a critical perspective (and not by means of a mechanical process which results in “boilerplate” presentations).

The MD&A Release provides interpretive guidance to public companies concerning the preparation of MD&A disclosures in filings under the Securities Act and Exchange Act. The MD&A Release constitutes the SEC’s response to a December 2001 petition submitted to the SEC by the Big Five accounting firms and endorsed by the American Institute of Certified Public Accountants, which petition proposed that the SEC provide additional guidance on MD&A disclosure. The MD&A Release adopts many of the suggestions advocated in the petition of the accounting industry. The MD&A Release does not purport to create new disclosure requirements or modify existing requirements. Instead, the MD&A Release sets forth guidelines for disclosures in the following areas that have become the focus of considerable attention in the post-Enron environment:

- liquidity and capital resources, including off-balance sheet arrangements and disclosures about contractual obligations and commitments;
- certain trading activities involving non-exchange traded contracts accounted for at fair value; and
- the effects of transactions with related and certain other parties.

The MD&A Release suggests that the quality and detail of information provided by public companies concerning these areas should be improved. In each of these areas, the SEC reviews basic principles that should inform disclosure and also provides lists of additional factors or considerations and, in some cases, suggested tabular formats that may be necessary or advisable to provide meaningful narrative explication of a company’s financial condition and results of operations. The MD&A Release also states that the SEC expects reporting companies to consider the contents of the release in connection with all upcoming and interim reports and other disclosure documents. We anticipate that the SEC staff will be scrutinizing MD&A disclosures for more comprehensive information responsive to the areas identified in the release.

Outside the context of the two releases, senior SEC staff members recently have indicated that the staff plans to allocate considerable resources during 2002 to review annual reports on Form 10-K filed by a substantial number of major U.S. public companies, with particular emphasis on MD&A disclosures and financial statements. In light of the two releases, public companies, in conjunction with their auditors and counsel, should take a “fresh look” at, and undertake a thorough analysis of, MD&A and other accounting-related disclosures in all upcoming filings under the Securities Act and the Exchange Act.

Copies of the Cautionary Advice Release and MD&A Release are attached to this memorandum.

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If you have any questions concerning the two releases, please contact John D. Lobrano, Vincent Pagano or Glenn M. Reiter of our firm at (212) 455-2000.

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