

New SEC Guidance on MD&A

On December 19, 2003, the SEC issued new guidance regarding the disclosure commonly known as Management's Discussion and Analysis of Financial Condition and Results of Operations, or MD&A, appearing in public companies' annual and quarterly reports and in their registration statements. This guidance is intended as an expansion of previous guidance and interpretations published by the SEC, particularly guidance published in 1989. The new guidance reiterates a number of salient disclosure concepts the SEC has been encouraging public companies to address for a number of years, but which the SEC believes a significant number of public companies still do not adequately cover. These concepts include:

- clearly focusing on key financial indicators used by management
- stressing and distinguishing truly material information
- expanding discussion on known material trends and uncertainties
- including narrative that provides an explanation and analysis of financial results, rather than repetition of numbers appearing in financial statements
- expanding and focusing the liquidity discussion
- addressing the material implications and uncertainties of the methods, assumptions and estimates underlying critical accounting policies

In addressing these concepts, the SEC provided a number of suggestions for overall improvement of the MD&A. Though couched as suggestions, we believe the SEC will use this new guidance as a measuring stick when evaluating a company's MD&A in registration

materials or periodic reports. Moreover, courts and litigants may rely on this guidance in applying the SEC's prohibitions against material misstatements or omissions in the context of the MD&A portion of securities documents.

Some practical tips for adequately addressing the new disclosure guidelines include:

- **Add an Executive Summary:** begin the MD&A with an executive summary which focuses on the key financial results, transactions, economic conditions, competitive landscape and risks that management would discuss in communications with analysts and institutional shareholders
- **Disclosure Must Be Forward Looking:** evaluate and expand trend and uncertainty disclosure – possibly the area of MD&A more than any other the SEC believes is not adequately addressed – in order to indicate whether past performance is indicative of future results; this analysis should be similar to that used to develop risk factor disclosure in registration statements, though the narrative would not be as detailed in the executive summary
- **Layered Approach:** build on the executive summary in the detailed narrative that follows, using what the SEC terms as a “layered” approach
- **Eliminate Redundancy:** replace narrative that restates financial information found in the financial

statements with summary tables showing percentage changes

- **Focus on What is Material:** eliminate discussions of non-material financial information and expand discussions on market, competitive and economic conditions that affect financial results or management's decision making
- **Liquidity and Funding:** when addressing liquidity, merely stating that a company has adequate resources to meet cash needs is not sufficient – the assertion should be supported by more detailed information, such as the sources of a company's cash, certainty of cash flow and need for capital; liquidity analysis should not be limited to a repetition of data found in the statement of cash flows – the company should focus on the factors that caused the line items in the cash flow statement to change
- **Financing Arrangements:** the liquidity and capital resources discussion should include disclosure of historical financing arrangements, including debt, off-balance sheet arrangements, derivatives linked to the company's stock, and the potential impact of known or reasonably likely changes to the company's credit ratings or its ability to access the debt or equity markets
- **Debt Instruments:** include disclosure of significant covenants in debt instruments where such covenants have been, or are reasonably likely to be, breached or where the covenant may impact the future ability of the company to undertake additional debt or equity financing
- **Critical Accounting Policies:** include the specific estimates and assumptions underlying critical accounting policies where the impact of the estimates and assumptions on financial conditions or operating performance is material, including whether and how the estimates or assumptions may have changed and

how the new estimates and assumptions were determined – it is not sufficient simply to refer to or repeat the disclosure contained in the notes to the financial statements.

The full text of the SEC guidance is available at www.sec.gov/rules/interp/33-8350.htm.

We would be pleased to assist you in assessing the adequacy of the MD&A – or any other disclosure – in your periodic reports or other SEC filings, such as registrations of securities offerings, and to provide you with legal advice as to any specific disclosure issue. If you have any questions or would like any assistance, please feel free to contact any of the attorneys listed on this page at (212) 912-7400 in New York or (800) 638-6409 in Washington, D.C., or by e-mail.

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PRACTICE GROUP

PARTNERS

W. Edward Bright (Chair)

Kofi Appenteng	Leonard T. Nuara
Robert C. Azarow	Lauris G. L. Rall
Charles D. Bethill	Richard A. Schaberg
V. Gerard Comizio	Mark I. Sokolow
Matthew Dyckman	Thomas N. Talley
Michael E. Helmer	Walter G. Van Dorn, Jr.
Douglas J. McClintock	Omer S.J. Williams

COUNSEL

W. Preston Granbery	Louis H. Nevins
---------------------	-----------------

Kathleen A. Wechter

ASSOCIATES

Micah A. Acoba	Thomas M. Laudise
Melissa A. Butler	Douglas E. Lippin
Christian H. Chandler	Marc H. Levin
Victoria L. Crane	Sabrina Minchella
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Jeffrey L. Hare	Constantine N. Skarvelis
Michael A. Jaffe	Pia K. Thompson

Scott D. Thompson

LEGISLATIVE/REGULATORY CONSULTANT

Barbara D. Burke

Email protocol is first initial and last name @tpwlaw.com
www.tpwlaw.com

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New York, NY
Two World Financial Center
New York, NY 10281
tel 212.912.7400
fax 212.912.7751

Washington, DC
1700 Pennsylvania Ave, NW
Washington, DC 20006
tel 202.347.8400
fax 202.626.1930

White Plains, NY
50 Main Street
White Plains, NY 10606
tel 914.421.4100
fax 914.421.4150

Summit, NJ
25 DeForest Ave
Summit, NJ 07901
tel 908.598.5700
fax 908.598.5710

México City, Mexico
Thacher Proffitt & Wood, S.C.
Avenida Paseo De La Reforma
No. 2620 - Piso 4
Colonia Lomas Altas
11950 México, D.F.
tel +525.55.257.2940
fax +525.55.257.2950