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June 5, 2020

U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Attention: Vanessa A. Countryman, Secretary

Re: *Management's Discussion and Analysis, Selected Financial Data, and Supplementary Financial Information*

Release No. 33-10750; 34-880093; File No. S7-01-20

Ladies and Gentlemen:

This letter is submitted on behalf of the Federal Regulation of Securities Committee (the "Committee") of the Business Law Section (the "Section") of the American Bar Association (the "ABA") on the above-referenced proposing release issued by the Securities and Exchange Commission (the "Commission") relating to proposed amendments to certain financial disclosure requirements in Items 301, 302 and 303 of Regulation S-K (the "Proposing Release"). We appreciate the opportunity to comment on the proposals.

The comments set forth in this letter represent the views of the Committee only and have not been approved by the ABA's House of Delegates or Board of Governors and, therefore, do not represent the official position of the ABA. In addition, this letter does not represent the official position of the Section nor does it necessarily reflect the views of all members of the Committee.

Overview

We support the Commission's ongoing efforts to modernize, simplify and enhance its requirements for public company disclosure. The Committee previously submitted comments in response to the Commission's request for public comment on ways to improve the content and presentation of business and financial information in SEC filings, as well as the Concept Release on Business

and Financial Disclosures Required by Regulation S-K (the "Concept Release").[1] This comment letter reiterates and builds upon our previous comments as they relate to the current proposals.

While we support the policy objectives stated in the release, we urge the Commission to take further steps to improve the quality of MD&A disclosure by refining and clarifying some of its existing rules, rather than simply streamlining the organizational framework and codifying past Commission guidance. Specifically, we urge the Commission to reconsider its previous guidance on forward-looking disclosure in MD&A, *i.e.*, the two-step test first articulated in its 1989 Interpretive Release (the "1989 two-step test"), which requires a negative presumption about the likelihood of occurrence that can result in a low threshold for disclosure.[2] We recommend that the Commission replace the 1989 two-step test with a disclosure standard that is consistent with the other disclosure standards applicable to Regulation S-K, as well as MD&A's objective of providing disclosure that reflects how management sees the business. As discussed in more detail below, and as we have previously recommended to the Commission, we strongly believe that the probability/magnitude test of materiality articulated by the U.S. Supreme Court in *Basic v. Levinson* is the appropriate standard for MD&A disclosure.[3] We believe the probability/magnitude test is well understood by registrants and their advisors. Applying it to MD&A disclosure would be more effective than the 1989 two-step test in guiding registrants to provide information about how management sees the business and would be consistent with the principles-based approach to MD&A.

If the Commission were, however, to decide not to adopt the probability/magnitude test, we recommend that it address some of the challenges of the 1989 two-step test. We believe that the negative presumption in the current test by its terms elicits disclosure of information that may not be material to investors because it does not reflect management's reasonable expectations about the impact of known trends and uncertainties. As explained more fully below, we respectfully submit that replacing the negative presumption with an affirmative determination would clarify the scope of the disclosure requirement and encourage management to focus its disclosure on information that is material to investors.

We also recommend a number of technical changes to the proposal to further improve the effectiveness of Item 303, and we provide comments on the Commission's proposals related to Items 301 and 302 of Regulation S-K. To assist the Commission, we have included as Exhibit A

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[1] See our comment letters, dated November 14, 2014 on Disclosure in Management's Discussion and Analysis about the Application of Critical Accounting Policies (available at https://www.sec.gov/comments/disclosure-effectiveness/disclosureeffectiveness-23.pdf) and dated December 15, 2017 on Business and Financial Disclosure Required by Regulation S-K (available at https://www.sec.gov/comments/s7-06-16/s70616-2812973-161696.pdf).

[2] *Management's Discussion and Analysis of Financial Condition and Results of Operations; Certain Investment Company Disclosures*, Release No. 33-6835 (May 18, 1989) [54 FR 22427 (May 24, 1989)] (the "1989 Interpretative Release").

[3] *Basic, Inc. v. Levinson*, 108 S. Ct. 978 (1988) (Under the materiality requirement of Rule 10b-5, with respect to contingent or speculative information or events, materiality "will depend at any given time upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity," at 213, citing *SEC v. Texas Gulf Sulphur Co.*, 401 F. 2d 833, at 849.)

a suggested revision of Item 303 that reflects our recommended approach to MD&A and other comments we are making.

Recommendations

Management's Discussion and Analysis

Known Trends or Uncertainties. In its 1989 Interpretive Release, the Commission stated that MD&A "mandates disclosure of specified forward-looking information, and specifies its own standard for disclosure - *i.e.*, reasonably likely to have a material effect."[4] In explaining how to apply this standard, the Commission articulated a two-step test:

> "Where a trend, demand, commitment, event or uncertainty is known, management shall make two assessments:
>
> (1) Is the known trend, demand, commitment, event or uncertainty likely to come to fruition? If management determines that it is not reasonably likely to occur, no disclosure is required.
>
> (2) If management cannot make that determination, it must evaluate objectively the consequences of the known trend, demand, commitment, event or uncertainty, on the assumption that it will come to fruition. Disclosure is then required unless management determines that a material effect on the registrant's financial condition or results of operations is not reasonably likely to occur."

In the Proposing Release, the Commission cites the 1989 two-step test in the context of proposed revisions to Item 303(a)(3)(ii), effectively confirming its support for the test.[5]

In our experience, the 1989 two-step test is complicated and difficult to apply, which is, in our view, inconsistent with the Commission's goal of simplifying registrants' compliance with Item 303 while modernizing and enhancing MD&A disclosure for investors. The 1989 two-step test is not set forth in Item 303 or any other Commission rule, such as Rule 12b-2, which defines "material" and applies to all of Regulation S-K.[6] Moreover, the 1989 two-step test, with its negative presumption, has the potential to require disclosure of known trends, demands, commitments, events or uncertainties (referred to herein as "known trends or uncertainties") that management does not reasonably expect to occur and, consequently, does not provide

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[4] Supra note 2, at fn. 27.

[5] Proposing Release, at fn. 139. We note that, although the Proposing Release refers to the 1989 two-step test, Item 303 as proposed to be amended would not itself indicate how to apply its disclosure requirements and therefore would continue the current uncertainties and difficulties in application.

[6] Exchange Act Rule 12b-2 provides that "the term 'material,' when used to qualify a requirement for the furnishing of information as to any subject, limits the information required to those matters to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to buy or sell the securities registered."

meaningful information to investors about how management views its business. At the same time, based on our collective experience we believe that in practice, due to its complexity and (at least to the non-lawyer) counterintuitive nature, many registrants do not actually apply the 1989 two-step test as the Commission envisaged, thereby creating at the very least a regulatory mismatch and possible enforcement exposure.[7]

We previously recommended that the Commission replace the 1989 two-step test with the probability/magnitude test adopted by the Supreme Court in *Basic v. Levinson*.[8] While we recognize that the Commission in 1989 declared that the *Basic* test for materiality "is inapposite to Item 303 disclosure," we again recommend that the Commission reconsider that position. The *Basic* test benefits from its simplicity, understandability and a long tradition of judicial and administrative interpretation. As a standard of materiality for forward-looking statements, it is consistent with the materiality standard of *TSC v. Northway,* which is reflected in Rule 12b-2, as well as the Staff Accounting Bulletin No. 99 test of materiality. Registrants, their advisors and accounting firms apply these materiality tests on a regular basis to provide disclosure that is meaningful to investors, and courts rely on those tests as well.

The probability/magnitude test is simpler for registrants to understand and apply in drafting MD&A disclosure and we believe would produce more meaningful disclosure about what management sees as the material known trends or uncertainties in its business. It enables management to balance probability of occurrence with the magnitude of the impact if it were to occur. For example, a trend or uncertainty may have a low probability of occurrence, but a large impact on the registrant's business if it does occur. In contrast, the 1989 two-step test is not, in our view, consistent with Item 303's objective of providing a discussion by management about known trends or uncertainties that management reasonably expects will occur. Thus, we strongly believe that probability/magnitude is the correct standard to apply to MD&A forward looking disclosure, just as it applies to other disclosure requirements.

Alternatively, if, despite our recommendation otherwise, the Commission maintains its view that the probability/magnitude test should not apply to Item 303, we urge the Commission to reformulate the two-step test to further the policy objectives of MD&A. We suggest the following approach, which we believe is more workable, would address some of the challenges of the 1989 two-step test and, by eliminating the negative presumption, would potentially improve the quality of information available to investors:

> Where a trend, demand, commitment, event or uncertainty is known, management should make two assessments:
>
> (1) Does management reasonably expect that the known trend, demand, commitment, event or uncertainty will occur?

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[7] In general, in-house finance and accounting teams (in other words, non-lawyers) take the lead in drafting the initial version of MD&A.

[8] See supra note 1.

(2) If so, the registrant should assess materiality as if the known trend, demand, commitment, event or uncertainty will occur, and provide disclosure if the impact on financial condition, results of operations or liquidity would be material.

Like the 1989 two-step test, this reformulated test for disclosure of known trends or uncertainties requires a registrant to make two separate determinations. First, the registrant must determine the likelihood that the known trend or uncertainty will occur, based on its reasonable expectation. If the registrant reasonably expects that the event will occur, then it must determine whether the impact of the event, assuming it does occur, would be material. The registrant must then provide disclosure if the impact would be material. We believe this reformulation of the 1989 two-step test, which replaces a negative presumption with an affirmative determination, would provide a more practical approach to preparing MD&A disclosure, and one that, in our experience, is more in line with the way registrants and their advisors, such as accountants and attorneys, analyze known trends and uncertainties disclosure. It would be easier for registrants to apply, elicit more meaningful forward-looking information, and allow registrants to reduce or eliminate disclosure of immaterial trends, events and uncertainties prompted by a negative presumption.

For the reformulated test we suggest the following as an alternative to Preliminary Note 2 in our recommended revision to Item 303 in Exhibit A:

> Preliminary Note 2: As used in this Item, "material" has the same meaning as in Rule 405 of the Securities Act (§ 230.405 of this chapter) and Rule 12b-2 of the Exchange Act (§ 240.12b-2 of this chapter). Where a trend, demand, commitment, event or uncertainty is known, management should make two assessments: (i) Does management reasonably expect that the known trend, demand, commitment, event or uncertainty will occur?, and (ii) If so, the registrant should assess materiality as if the known trend, demand, commitment, event or uncertainty will occur, and provide disclosure if the impact would be material. References in this Item to "discussion" shall include "analysis" where appropriate.

If the Commission adopts either of these alternatives, we strongly recommend including a clear statement in the adopting release that the 1989 two-step test is superseded and no longer applies. If the Commission instead decides to "codify" the 1989 two-step test, we urge that it do so by placing the test in the regulatory text or a preliminary note to make it more accessible to preparers of MD&A.

Reasonably Likely vs. Reasonably Expects. Item 303(a)(3)(ii) currently requires a registrant to describe known trends or uncertainties that the registrant "*reasonably expects* will have a favorable or unfavorable impact on net sales or revenues or income from continuing operations." The Item also provides that when a registrant knows of events that "*will cause* a material change in the relationship between costs and revenues," the registrant must disclose the change in that relationship. The Commission proposed to amend the latter provision to require disclosure when known events are "*reasonably likely* to cause a material change in the relationship between costs and revenues," instead of events that "*will cause*" a material change.

The Commission did not propose changes to the "reasonably expects" standard in the first sentence of Item 303(a)(3)(ii).

The proposing release provides little explanation for this proposed change, noting only that it would "conform the language in this paragraph to other Item 303 disclosure requirements for known trends, and align Item 303(a)(3)(ii) with the Commission's guidance on forward looking disclosure," citing the 1989 two-step test.[9] While we support the Commission's goal of establishing a consistent disclosure standard for known trends and uncertainties, we believe that "reasonably expects" (which is currently used in the first sentence of Item 303(a)(3)(ii)) is a better standard than "reasonably likely."

We acknowledge that "reasonably likely" appears in other parts of Item 303 and the Commission used it throughout the 1989 Interpretive Release. We also acknowledge that the argument over "reasonably likely" vs. "reasonably expects" might be viewed as a matter of form over substance. Both standards require the exercise of judgment. We believe, however, that the "reasonably expects" language is more consistent with MD&A's goal of giving investors an opportunity to look at the company through the eyes of management. Instead of the language of the proposal, we recommend that the Commission eliminate the "reasonably likely" standard throughout those portions of Item 303(a) that address known trends or uncertainties and instead require disclosure when the registrant "reasonably expects [the trends or uncertainties] will cause" a material change, consistent with the first sentence of Item 303(a)(3)(ii).[10]

Objectives. The Commission proposed adding a new Item 303(a) to "succinctly state the purposes of MD&A." As proposed, the new subparagraph (a) would describe the objectives of MD&A, incorporating into the rule portions of the current Instructions to Item 303 and previous Commission guidance. We support the Commission's goal of consolidating various statements about the purpose of MD&A that currently are dispersed across the rule, its instructions, and prior guidance. We agree that providing a clear articulation of the regulatory purpose that precedes the technical requirements of the rule may help guide registrants to prepare disclosure that is more effective. However, to avoid confusion, we recommend that these objectives be presented as a Preliminary Note to the regulatory text, consistent with the Commission's approach in other rules, such as Rules 144, 144A, and 145, rather than the proposed approach of incorporating the objectives into the regulatory text.

A preliminary note is not a rule but is instrumental to a registrant's understanding of and complying with a principles-based rule. The preliminary note to Rule 144, for example, states the intent and effect of the rule but is not a separate requirement of the rule and does not affect the substantive operation of the rule.[11] If the Commission were to include the objectives as a

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[9] See Proposing Release at page 49 and footnotes 138 and 139. See supra note 5.

[10] If the Commission adopts this recommendation while retaining the 1989 two-step test, we urge the Commission to also restate the two-step test to apply the "reasonably expects" standard instead of "reasonably likely" to avoid confusion.

[11] *Revisions to Rules 144 and* 145, Release No. 33-8869 (December 6, 2017) [72 FR 71546 (December 17, 2007)] at fn. 17 and Sec. II. A.

separate requirement in Item 303, the objectives would then become a disclosure requirement with increased and uncertain legal risk. We note that the Commission's proposal generally relocates information from the current instructions to Item 303 and from its prior guidance into the objectives, which suggest the Commission does not intend for the objectives to create a new line-item disclosure requirement. As proposed, the objectives do not identify disclosures that a registrant must make but rather explain the desired effect of the disclosure requirement and thus are more appropriate as a preliminary note. Moreover, we believe that use of Preliminary Notes to rules reduces the need for registrants as well as courts to try to assess the Commission's intent.

We recommend that the Commission consider providing a clear statement in the adopting release that omission of disclosure required by an SEC rule does not, per se, constitute a violation of a duty to disclose under Exchange Act Section 10(b) or Rule 10b-5. It is our view that Item 303 provides a disclosure standard solely for purposes of reporting under Exchange Act Section 13(a), to be enforced by the Commission. We believe Item 303 is not intended to establish a disclosure duty that is enforceable under Section 10(b) and Rule 10b-5. We respectfully request that the Commission confirm this view through a statement in the adopting release to provide clarity and assurance to registrants. This is particularly important to registrants since the U.S. Supreme Court did not review the U.S. Court of Appeals for the Second Circuit's decision in Indiana Public Retirement System v. SAIC, Inc., 818 F.3d 85 (2d Cir. 2016), thus continuing the uncertainty created by the Circuit Courts' split on this issue.[12]

Must vs. Should. The best disclosure uses words that are plain and clear, and similarly we want to emphasize the importance of the words that the Commission uses in crafting its disclosure requirements. In our proposed changes to Item 303, we recommend in numerous places that, consistent with the principles-based nature of MD&A disclosure, the Commission use the word "should" rather than the word "must" in its regulatory text and the instructions. In our opinion, these two words are not interchangeable and only "should" allows registrants the requisite flexibility to assess their own facts and circumstances and provide their investors with the disclosures that will be most useful to them. As the recent COVID-19 pandemic and its far-reaching effects on corporate issuers and the capital markets alike have shown, public companies and investors exist in a constantly changing and at times fragile world. The use of "must" is a directive that leaves little room for judgment, turns the directive into a "checklist item," and potentially creates exposure to absolute liability for failure to follow a Commission mandate. We think it is far better to lay out principles and guideposts to provide a frame upon which registrants will build their own disclosures.

Investors are best-served by understanding the companies in which they invest through the eyes of the management who run those companies. Disclosure rubrics that are based on "should" or even "should consider" allow registrants to provide their investors with the most relevant and useful disclosures at any point in time, without fear of a "gotcha" regime where the failure to strictly comply with a "must" requirement could lead to liability and second-guessing or, worse, where companies feel so obliged to comply with such a mandate that it results in inundating investors with disclosures that do not actually provide any real insight or

[12] See Linda L Griggs., John J. Huber and Christian J. Mixter "When Rules Collide --Leidos, the Supreme Court, and the Risk to the MD&A," (SECURITIES REGULATION & LAW REPORT, 49 SRLR 1511, 09/25/2017).

understanding. We believe that an MD&A disclosure regime that hews closely to its principle-based core is in the best interest of registrants and investors alike, and those principles are best communicated with "should" rather than "must."

Critical Accounting Estimates

We support the Commission's proposal to amend Item 303(a) to expressly require disclosure of critical accounting estimates.[13] Consistent with recommendations in our previous comment letters, we also support the inclusion of an instruction specifying that the discussion of critical accounting estimates in MD&A should supplement, not duplicate, information included in the footnotes to the financial statements. We continue to believe that disclosure of the registrant's critical judgments and assumptions about significant estimates in its historical financial statements would enhance an investor's understanding of the predictive nature of those statements, and we generally support the line item requirements included in the proposal. However, we do not support the aspects of the proposed requirement that call for quantification and speculation about what might occur in the future.

New item 303(b)(4) would require registrants to "[d]iscuss, to the extent material, why each critical accounting estimate is subject to uncertainty . . . ." We believe that is a sensible approach that will require registrants to provide a thoughtful discussion of the estimate and the critical judgments and assumptions that go into it. However, the proposal goes on to require a discussion of "how much each estimate has changed during the reporting period, and the sensitivity of the reported amount to the methods, assumptions and estimates underlying its calculation." On the first requirement – how much the estimate has changed during the reporting period – it is not clear what purpose this requirement serves. Estimates are almost certain to change quarter to quarter, and that change will be reflected in the amount that appears in the historical financial statements. If the change in the reported amount is material, the registrant is already required to discuss and analyze it as part of the MD&A.

We are concerned that a requirement such as this could force registrants into a check-the-box compliance exercise of quantifying their estimate every quarter and disclosing it, whether or not the information was material to investors. We believe the requirement to identify material known trends or uncertainties is sufficient to address the information that needs to be conveyed about material changes in estimates. To illustrate, the current economic situation explains a reason for many increases in estimated uncollectible accounts and would, to the extent material, likely to be one of the disclosed consequences of the current situation.

For similar reasons, we do not favor a requirement that a registrant discuss "the sensitivity of the reported amount to the methods, assumptions and estimates underlying its calculation." The proposed reference to sensitivity suggests that the registrant is required to provide quantification in every case. Quantification could require an analysis of which of the various interrelated and complex assumptions and judgments that affect a critical accounting estimate should be quantified. Instead of mandating a sensitivity analysis, we recommend that the Commission leave it to registrants to decide whether inclusion of a quantitative analysis

[13] See *supra* Note 1.

would provide meaningful information to investors. The estimate that is embedded in the amount that appears in the financial statements represents management's best estimate of the most likely scenario. Asking the registrant now to engage in a "what if" sensitivity analysis would (1) be a purely mathematical exercise of plugging in different numbers and (2) require the registrant to present scenarios that it does not believe are the most likely to occur. Moreover, a sensitivity analysis would not be helpful without some discussion and analysis of the likelihood of the different scenarios occurring, and very quickly this section of the MD&A will have become quite extensive. We made a similar point in our comment letter on the 2002 proposal.[14]

Finally, we think adding the instruction to Item 303(b)(4) clarifying that critical accounting estimates disclosure is intended to supplement, not repeat, the description of significant accounting policies in the notes to the financial statements would help registrants avoid the problem we have seen too often with disclosures of critical accounting estimates becoming just a repetition of the significant account policies financial statement note.

Selected Financial Data and Supplementary Financial Information

We support the Commission's proposal to eliminate the requirements to provide selected financial data and supplementary financial information under Items 301 and 302(a) of Regulation S-K, respectively. We believe the availability of a registrant's historical financial information on the SEC's EDGAR system and typically on the registrant's website provides investors with access to material information, and eliminating these disclosure requirements would not affect the total mix of information available to investors.

Selected Financial Data. If the Commission chooses to retain Item 301, we recommend that the requirement be limited to providing information for the most recent three fiscal years. For registrants that include less than three years of financial information in their filings, a third-year of selected financial data would provide additional context for investors to evaluate the two years of financial statements provided. Similarly, for registrants that omit the earliest of three years in their year-to-year comparisons, selected financial data for the most recent three years would be useful to investors in placing the comparative discussion in context. In addition, if the Commission chooses to retain Item 301, we recommend that the Commission revise current Instruction 2 to eliminate the mandatory disclosure items and instead allow registrants to decide which line items would enhance an understanding of, and highlight trends in, their financial condition and results of operations. This more principles-based approach to selected financial data disclosure would further the Commission's objective of providing investors with information about management's view of the business. As noted above, however, we support the proposed elimination of Item 301.

Supplemental Financial Information. While we support the Commission's proposal to eliminate Item 302(a), we share the concern of some commenters about the loss of a separate

[14] See our comment letter, dated July 24, 2002 on Disclosure in Management's Discussion and Analysis About the Application of Critical Accounting Policies - File No. S7-16-02 (July 24, 2002 (available at https://www.sec.gov/rules/proposed/s71602/skeller1.htm).

presentation of certain fourth quarter information and the effects of material retrospective changes in the financial statements. We also agree with the Commission's statement in the Proposing Release that material fourth quarter results or retrospective changes should be disclosed under the existing requirements of Item 303.[15] To avoid uncertainty, however, we urge the Commission to include an instruction to Item 303, clarifying that when fourth quarter results differ materially from previously reported quarterly information, the registrant should discuss the fourth quarter results in MD&A. In addition, we recommend an instruction, similar to the current requirement in Item 302(a)(2), to clarify that material retrospective changes should be disclosed and reconciled with amounts previously reported. We believe this approach would allow registrants to eliminate redundant disclosure while providing investors with access to material information.

Compliance Date

The Commission proposed a compliance date of 180 days after effectiveness of any final rule, with early compliance permitted. We agree that these rule amendments, if adopted, may require registrants to make significant adjustments to their disclosures, and that a meaningful transition period is appropriate. We urge the Commission, however, to modify the proposed compliance date such that that a registrant would be required to first comply with the new rules in its first annual report on Form 10-K or Form 20-F that is due on or after the rules' effective date. We further recommend that the Commission make the effective date of the rules 180 days after publication in the Federal Register and tie the compliance date to the registrant's first annual report due on or after the effective date, to provide all registrants with a minimum transition period of 180 days, as proposed, with early adoption permitted.

This compliance date adjustment would allow registrants to first prepare MD&A disclosure under the new rules in an annual report, which would then serve as a new MD&A "template" for all subsequent periodic reports. We understand that due to differing fiscal year-end dates, not all registrants would implement the new rules at the same time. We believe, however, that this result is preferable to requiring some registrants to first comply with the new rules in a quarterly report on Form 10-Q when disclosure in its previously filed annual report was prepared under the prior rules. This approach recognizes that Form 10-Q disclosures are based upon and supplemental to the preceding Form 10-K disclosures.

Prior Commission Guidance

The Proposing Release cites previous MD&A interpretive releases[16] as support for the proposals, and to some extent the proposals would codify prior Commission guidance. We have

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[15] Proposing Release, p. 27.

[16] *See, e.g., Commission Guidance on Presentation of Liquidity and Capital Resources Disclosures in Management's Discussion and Analysis*, Release No. 33-9144 (Sept. 17, 2010) [75 FR 59894 (Sept. 28, 2010)]; *Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operation*, Release No. 33-8350 (Dec. 19, 2003) [68 FR 75056 (Dec. 29, 2003)]; *Commission Statement About*

long supported consolidation and codification of existing staff and Commission-level MD&A guidance, and we support the Commission's efforts to codify certain aspects of its previous guidance through this proposal. We recommend that the Commission include a statement in the adopting release to clarify the status of its previous MD&A interpretive releases. Specifically, we suggest that the Commission include language in the adopting release making clear that registrants should no longer rely on those portions of the Commission's previous interpretive guidance that are superseded by the amended rule.[17] Consolidating the Commission's current views on MD&A disclosure into the adopting release would provide greater certainty and ease the compliance burden for registrants.

* * *

We appreciate the opportunity to comment on the Commission's Proposing Release and respectfully request that the Commission and the staff consider our recommendations and suggestions. We are available to meet and discuss these matters with the Commission or the staff, and respond to any questions, at your convenience.

Very truly yours,

Robert E. Buckholz
Chair, Federal Regulation of Securities Committee
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Management's Discussion and Analysis of Financial Condition and Results of Operations, Release No. 33-8056 (Jan. 22, 2002) [67 FR 3746 (Jan. 25, 2002)]; 1989 Interpretive Release.

[17] If the Commission decides not to accept this recommendation, we nevertheless urge the Commission to make clear the status of the 1989 two-part test, as previously stated on page 5 of this letter.

EXHIBIT A

§ 229.303 (Item 303) Management's discussion and analysis of financial condition and results of operations.

Preliminary Note 1: The objective of this Item is to provide information material to an assessment of the financial condition, results of operations and liquidity of the registrant, including an evaluation of the amounts and certainty of cash flows from operations and from outside sources. The discussion and analysis should:

a. Provide a narrative explanation of the registrant's financial statements that allows investors to view the registrant's business through the eyes of management;

b. Include statistical data that management believes will enhance an investor's understanding of the registrant's financial condition, changes in financial condition and results of operations; and

c. Focus specifically on events, demands, commitments, trends and uncertainties (hereinafter referred to as "trends or uncertainties") known to management that management reasonably expects will cause future operating results or financial condition to be materially different from those in the current reporting period.

Preliminary Note 2: As used in this Item, "material" has the same meaning as in Rule 405 under the Securities Act (§ 230.405 of this chapter) and Rule 12b-2 under the Exchange Act (§ 240.12b-2 of this chapter). When determining the materiality of forward-looking information, registrants should balance the probability that the trend or uncertainty will occur and the anticipated magnitude of the event in light of the registrant's business as a whole. References in this Item to "discussion" shall include "analysis" where appropriate.

(a) *Full fiscal years.* Discuss the registrant's financial condition, results of operations and cash flow by providing the information specified in paragraphs (a)(1) through (4) of this section and such other information that the registrant believes to be necessary to an understanding of its financial condition, results of operations and cash flow and expected changes in financial condition, results of operations and cash flow. Where the financial statements reflect material changes from period-to-period in one or more line items, including where material changes within a line item offset one another, describe the underlying reasons for these material changes in quantitative and qualitative terms to the extent necessary to an understanding of the registrant's businesses as a whole. Where in the registrant's judgment a discussion of segment information and/or of other subdivisions (e.g., geographic areas, product lines) of the registrant's business would be necessary to an understanding of such business, discuss each relevant segment and/or other subdivision of the business and its impact on the registrant's business as a whole.

(1) *Liquidity.* Identify any known trends or uncertainties that have resulted or that the registrant reasonably expects will result in the registrant's liquidity increasing or decreasing in any material way. If a material deficiency is identified, indicate the course of action that the registrant has taken or proposes to take to remedy the deficiency. Also identify and separately describe material internal and external sources of liquidity, and briefly discuss any material unused sources of liquid assets.

(2) *Capital resources.*

(i) Describe the registrant's material cash requirements, including commitments for capital expenditures, as of the end of the latest fiscal period, the anticipated source of funds needed to satisfy such cash requirements and the general purpose of such requirements.

(ii) Describe any known trends or uncertainties, favorable or unfavorable, that have had or that the registrant reasonably expects will have a material effect on the registrant's capital resources. Indicate any expected material changes in the mix and relative cost of such resources and any material changes between equity, debt and any off-balance sheet financing arrangements.

(3) *Results of operations.*

(i) Describe any unusual or infrequent events or transactions or any significant economic changes that materially affected the amount of reported income from continuing operations and, in each case, indicate the extent to which income was so affected. In addition, describe any other significant components of revenues or expenses that, in the registrant's judgment, would be material to an understanding of the registrant's results of operations.

(ii) Describe any known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations. If the registrant knows of events that it reasonably expects will cause a material change in the relationship between costs and revenues (such as known or reasonably expected future increases in costs of labor or materials or price increases or inventory adjustments), describe the reasonably expected change in the relationship.

(iii) If the statement of comprehensive income presents material changes from period to period in net sales or revenue, if applicable, describe the extent to which such changes are attributable to changes in prices or to changes in the volume or amount of goods or services being sold or to the introduction of new products or services.

(4) *Critical accounting estimates.* Critical accounting estimates are those estimates made in accordance with generally accepted accounting principles that involve a significant level of estimation uncertainty and have had or that the registrant reasonably expects will have a material impact on financial condition or results of operations. Discuss why each such critical accounting estimate is subject to uncertainty, whether the estimate has changed materially during the reporting period, and the methods and assumptions underlying the estimate. Discuss quantitative information when it is reasonably available and both quantitative and qualitative information if management believes that both quantitative and qualitative information will provide material information to investors.

Instructions to paragraph 303(a):

1. Generally, the disclosure should discuss and analyze the periods covered by the financial statements included in the filing and the registrant may use any presentation that in the registrant's judgment enhances a reader's understanding. A smaller reporting company's discussion should cover the two-year period required in Article 8 of Regulation S-X and may use any presentation that in the registrant's judgment enhances a reader's understanding. For registrants providing financial statements covering three years in a filing, discussion about the earliest of the three years may be omitted if such discussion was already included in the registrant's prior filings on EDGAR that required disclosure in compliance with Item 303 of Regulation S-K, provided that registrants electing not to include a discussion of the earliest year must include a statement that identifies the location in the prior filing where the omitted discussion can be found. An emerging growth company, as defined in Rule 405 of the Securities Act (§ 230.405 of this chapter) or Rule 12b-2 of the Exchange Act (§ 240.12b-2 of this chapter), may provide the discussion and analysis required in paragraph (b) of this section for its two most recent fiscal years if, pursuant to Section 7(a) of the Securities Act of 1933 (15 U.S.C. 77g(a)), it provides audited financial statements for two years in a Securities Act registration statement for the initial public offering of the emerging growth company's common equity securities.

2. Discussions of liquidity and capital resources may be combined whenever the two topics are interrelated.

3. If the reasons underlying a material change in one line item in the financial statements also relate to other line items, no repetition of such reasons in the discussion is required and a line-by-line analysis of the financial statements as a whole is not required or generally appropriate. Registrants need not recite the amounts of changes from period to period that are readily computable from the financial statements. The discussion must not merely repeat numerical data contained in the financial statements.

4. The term "liquidity" as used in this Item refers to the ability of an enterprise to generate adequate amounts of cash to meet the enterprise's needs. Except where it is otherwise clear from the discussion and analysis, the registrant should indicate those balance sheet conditions or income or cash flow items which the registrant believes may be indicators of its liquidity condition. Liquidity generally should be discussed on both a long-term and short-term basis. The issue of liquidity should be discussed in the context of the registrant's own business or businesses. For example, a discussion of working capital may be appropriate for certain manufacturing, industrial, or related operations but might be inappropriate for a bank or public utility

5. Where financial statements presented or incorporated by reference in the registration statement are required by § 210.4-08(e)(3) of Regulation S-X [17 CFR

Part 210] to include disclosure of restrictions on the ability of both consolidated and unconsolidated subsidiaries to transfer funds to the registrant in the form of cash dividends, loans or advances, the discussion of liquidity should include a discussion of the nature and extent of such restrictions and the impact such restrictions have had or are expected to have on the ability of the parent company to meet its cash obligations.

6. Any forward-looking information supplied is expressly covered by the safe harbors for projections. See Section 27A of the Securities Act and Rule 175 promulgated thereunder [17 CFR 230.175], and Section 21E of the Exchange Act and Rule 3b-6 promulgated thereunder [17 CFR 240.3b-6], and Securities Act Release No. 6084 (June 25, 1979) (44 FR 33810).

7. All references to the registrant in the discussion and in this Item mean the registrant and its subsidiaries consolidated.

8. Discussion of commitments or obligations, including contingent obligations, arising from arrangements with unconsolidated entities or persons that have had or that the registrant reasonably expects will have a material current or future effect on a registrant's financial condition, revenues or expenses, results of operations, cash flow, liquidity, cash requirements or capital resources should be provided even when the arrangement results in no obligations being reported in the registrant's consolidated balance sheets. Such off-balance sheet arrangements may include: guarantees; retained or contingent interests in assets transferred; contractual arrangements that support the credit, liquidity or market risk for transferred assets; obligations that arise or could arise from variable interests held in an unconsolidated entity; or obligations related to derivative instruments that are both indexed to and classified in a registrant's own equity under U. S. GAAP.

9. If the registrant is a foreign private issuer, briefly discuss any pertinent governmental economic, fiscal, monetary, or political policies or factors that have materially affected or that the registrant reasonably expects could materially affect, directly or indirectly, its operations or investments in the registrant by United States nationals. The discussion should also consider the impact of hyperinflation if hyperinflation has occurred in any of the periods for which audited financial statements or unaudited interim financial statements are filed. See Rule 3-20(c) of Regulation S-X for a discussion of cumulative inflation rates that may trigger this requirement.

10. If the registrant is a foreign private issuer, the discussion should focus on the primary financial statements presented in the registration statement or report. The foreign private issuer should refer to the reconciliation to United States generally accepted accounting principles, if any, and discuss any aspects of the difference between foreign and United States generally accepted accounting principles, not discussed in the reconciliation, that the registrant believes is necessary for an understanding of the financial statements as a whole, if applicable.

11. The term statement of comprehensive income means a statement of comprehensive income as defined in §210.1-02 of Regulation S-X.

Instruction to paragraph 303(a)(4): The disclosure of critical accounting estimates should supplement, but not duplicate, the description of accounting policies or other disclosures in the notes to the financial statements.

(b) *Interim periods.* If interim period financial statements are included or are required to be included by Article 3 of Regulation S-X [17 CFR 210.3], discuss and analyze the registrant's financial condition, results of operations and cash flow so as to enable the reader to assess material changes in financial condition, results of operations and cash flow between the periods specified in paragraphs (b)(1) and (2) of this section. The discussion and analysis should include a discussion of material changes in those items specifically listed in paragraph (a) of this section.

(1) *Material changes in financial condition.* Discuss and analyze any material changes in financial condition from the end of the preceding fiscal year to the date of the most recent interim balance sheet provided. If the interim financial statements include an interim balance sheet as of the corresponding interim date of the preceding fiscal year, any material changes in financial condition from that date to the date of the most recent interim balance sheet provided also should be discussed. If discussions of changes from both the end of the preceding fiscal year and the corresponding interim date of the preceding fiscal year are required, the discussions may be combined at the discretion of the registrant.

(2) *Material changes in results of operations.*

(i) Discuss and analyze any material changes in the registrant's results of operations with respect to the most recent fiscal year-to-date period for which a statement of comprehensive income is provided and the corresponding year-to-date period of the preceding fiscal year.

(ii) Discuss and analyze any material changes in the registrant's results of operations with respect to either the most recent quarter for which a statement of comprehensive income is provided and the corresponding quarter for the preceding fiscal year or, in the alternative, the most recent quarter for which a statement of comprehensive income is provided and the immediately preceding sequential quarter. If the latter immediately preceding sequential quarter is discussed, then explain why that comparison is meaningful for investors and provide in summary form the financial information for that immediately preceding sequential quarter that is the subject of the discussion or identify the registrant's prior filings on EDGAR that present such information. If there is a change in the form of presentation from period to period that forms the basis of comparison from previous periods provided pursuant to this paragraph, discuss the reasons for changing the basis of comparison and provide both comparisons in the first filing in which the change is made.

Instructions to paragraph 303(b):

1. If interim financial statements are presented together with financial statements for full fiscal years, the discussion of the interim financial information should be prepared pursuant to this paragraph (b) and the discussion of the full fiscal year's information should be prepared pursuant to paragraph (a) of this Item. Such discussions may be combined. Instructions 3, 6, 8 and 11 to paragraph (a) of this section apply to this paragraph (b).

2. The registrant's discussion of material changes in results of operations should identify any significant elements of the registrant's income or loss from continuing operations that do not arise from or are not necessarily representative of the registrant's ongoing business.