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COMMITTEE ON SECURITIES REGULATION

July 15, 2002

Via email: rule-comments@sec.gov
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Attention: Jonathan G. Katz, Secretary

Re: File No. S7-16-02; Release No. 33-8098
Proposed Rule: Disclosure in Management's Discussion and Analysis about the Application of Critical Accounting Policies

Ladies and Gentlemen:

This letter is submitted on behalf of the Committee on Securities Regulation of the Association of the Bar of the City of New York (the "Committee") in response to Release No. 33-8098, dated May 10, 2002 (the "Release"), in which the Securities and Exchange Commission (the "Commission") announced a proposed rule requiring disclosure in Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") of critical accounting estimates and policies (the "proposed rule" or "proposal"). Our Committee is composed of lawyers with diverse perspectives on securities issues, including members of law firms, counsel to corporations, investment banks, investors and academics.

I. Introduction

The Committee supports the Commission's efforts to improve the quality and "transparency" of financial disclosure by filing companies. In particular, we agree with the Commission's intent to make important exercises of judgment by management more visible to investors and analysts. We recognize that inherent in all registrants' financial statements are critical accounting estimates and that requiring additional disclosure of these estimates may serve to provide a better understanding of a company's financial condition and results of operations. Similarly, the Committee supports the Commission's desire to focus attention on a company's adoption of accounting principles.

Notwithstanding the possible costs and time required to comply with the proposed disclosure requirements, the Committee believes that, in general, the proposed disclosure about assumptions used in critical accounting estimates, if possible to do simply and concisely, will benefit investors by providing additional information with which to make investment decisions. The Committee is concerned, however, with the extensive scope of the new disclosures required under the proposed rule and, particularly, the difficulties inherent in the achievement of compliance by individual companies. The SEC's proposal to add substantially to MD&A by requiring disclosure of generally complex accounting assumptions and policies can only be justified if, in fact, the additional disclosure results in more meaningful and clear disclosure that is useful to investors. MD&A is designed to let investors see an issuer through the eyes of its management. To the extent the proposal mandates disclosure about scenarios that are less than likely to occur or results in disclosure that is overly-complex and obscure, this type of disclosure will reduce confidence in MD&A. In particular, the Committee recognizes that in the actual application of the proposed rule, managements will feel the need to justify their choices and be sure they are understood in the appropriate context, leading to long and necessarily complicated explanations. The added disclosure requirement coupled with the inherent pressure on management to explain the basis for their assumptions and estimates to avoid exposure to liability if the estimates, in hindsight, prove inaccurate, is likely to be costly, time consuming and create even longer MD&A for many companies without necessarily accomplishing the Commission's goal of improving the public's understanding of the accounting estimates and policies that underlie a reporting company's financial statements.

The Committee suggests, at a minimum, that the SEC limit the burdens of compliance with the proposed rule by revising the proposal to clearly call for only the most salient and important disclosures. As drafted, the proposed rule will result in an overly detailed, complex and lengthy new disclosure by requiring a discussion of a wide range of specific new topics within the MD&A. Merely setting forth the expected disclosure, as the Release does in Section III.C., leads to the conclusion that MD&A will inevitably expand in length and complexity in dramatic fashion. The Release identifies and describes that issuers will be required to disclose:

- the top critical accounting estimates and the methodology used in determining each of these estimates;
- any underlying assumption that is about highly uncertain matters and any other underlying assumption that is material;
- any known trends, demands, commitments, events or uncertainties that are reasonably likely to occur and materially affect the methodology or the assumptions described;
- if applicable, why different estimates that would have had a material impact on the company's financial presentation could have been used in the current period;
- if applicable, why the accounting estimate is reasonably likely to change from period to period with a material impact on the financial presentation;
- an explanation of the significance of the accounting estimate to the company's financial condition, changes in financial condition and results of operations and, where material, an identification of the line items in the company's financial statements affected by the accounting estimate;

- a quantitative discussion of changes in overall financial performance and, to the extent material, line items in the financial statements if the company were to assume that the accounting estimate were changed, either by using reasonably possible near-term changes in the most material assumption(s) underlying the accounting estimate or by using the reasonably possible range of the accounting estimate;
- a quantitative and qualitative discussion of any material changes made to the accounting estimate in the past three years, the reasons for the changes, and the effect on line items in the financial statements and overall financial performance;
- a statement of whether or not the company's senior management has discussed the development and selection of the accounting estimate, and the MD&A disclosure regarding it, with the audit committee of the company's board of directors;
- if the company operates in more than one segment, an identification of the segments of the company's business the accounting estimate affects; and
- a discussion of the accounting estimate on a segment basis, to the extent that a failure to present that information would result in an omission that renders the disclosure materially misleading.

We are concerned that investors and the market will reap little benefit from these disclosures unless they are more focused. Of these requirements, the Committee believes that, in general, the proposed disclosure about assumptions used in critical accounting estimates, if possible to do simply and concisely, will benefit investors by providing additional information with which to make investment decisions.

We also anticipate that immediate implementation would be extremely difficult for many filing companies due to the substantial scope of the additional disclosures (as discussed above) and inherent problems in compliance in specific situations (as discussed more fully below in Part II). The Committee strongly urges the Commission to phase-in application of the new rule over a period of time and in stages to allow companies to develop and implement appropriate processes for compliance and so that the SEC can develop and issue interpretations and other guidance to issuers. For example, the initial adoption of the proposed rule might at first require implementation only in Form 10-Ks and not require updating in Form 10-Qs until the market, the Commission and companies have been given a chance to adapt to the new reporting requirements. Alternatively, the proposed rule could initially apply only to specific categories of estimates, such as reserves or interest rates, or the new disclosure regime initially might not be required on a segment basis. It may also prove useful to have a small number of companies voluntarily comply with the new disclosure requirements on a pilot basis, similar to the method used in the implementation of the SEC's plain English rules. We believe that the complexity and significant compliance difficulties associated with the proposed rule are at least as complex as those associated with the plain English rule, but that the legal and market implications of inadvertent non-compliance with the proposed rule are significantly more serious. The Commission could then require all other companies to comply perhaps a year later, thereby giving the Commission (and other registrants) the opportunity to observe the rule in actual practice as well as effect any necessary amendments and issue clarifications and interpretations. Finally, the Committee strongly urges that the historic reporting requirements be phased-in only for the years following the implementation of the rule, thereby avoiding problems of re-creating estimates for years in which the rule did not apply and potentially causing unnecessary confusion and loss of confidence among investors.

The foregoing recommendations to phase-in the proposed rule reflect the Committee's effort to avoid investor confusion and loss of confidence that we believe will result if issuers must submit significant amendments to MD&A disclosure in Form 10-Ks and Form 10-Qs based on SEC comments that demonstrate significant differences in the SEC's and issuers' understanding of the requirements. We believe that such differences should be clarified during the phase-in period. We further believe that the goals of the proposed rule can be achieved only if uniform disclosure results and that the guidance of the Commission provided in the Release will not achieve this result.

The Committee believes that the company's constituencies most affected by the proposed rule are investors, research analysts, underwriters and accountants. Investors will appreciate a more thorough disclosure of accounting estimates and policies, but many, particularly non-investment professionals, may be overwhelmed by the complexity of the disclosure that would be required by the proposed rule. Research analysts will likely welcome the increased volume of information provided by these new disclosure requirements, so long as the disclosure is uniform and consistent. The additional information may improve the quality of the reports written by analysts, thereby benefiting the investor who reads those reports. Underwriters, however, will be alarmed by the prospect of new avenues for liability and seek ways to insulate themselves through expanded due diligence, possibly requiring an accountant's comfort letter or another form of accountant's review of MD&A. Accountants may similarly be concerned about their own increased liability that might be associated with an examination or review of this expanded MD&A and resist undertaking such a review. In addition, the changes in accountants that many companies are making as a result of Arthur Andersen's collapse will further increase the burden placed on a company's auditors. Managements will have to be able to tell their audit committees that they have consulted with their auditors about the new disclosure in the MD&A and managements will want to have the input of their auditors in identifying and making the critical accounting estimates before meeting with their audit committees.

The Committee is concerned that the practical implementation of the disclosure requirements will be extremely difficult for individual issuers with respect to specific situations. We believe that the difficulties of developing the disclosures required by the proposed rule are substantial and will be wide-spread. We further anticipate that SEC staff will be burdened and experience considerable difficulties providing guidance through telephone and letter interpretations, no-action letters and reviews of filings, as issuers seek clarification of the application of the proposed rule to the myriad number of fact patterns to which the proposed rule will apply. As a new form of disclosure, it behooves the SEC to proceed cautiously to avoid creating confusion in the market place by ensuring that it adopts the proposed rule with considerably enhanced clarification of the proposed requirements, focusing the rule only on the most significant disclosures, and carefully phasing-in compliance with the rule.

II. Proposed Disclosure about Critical Accounting Estimates

The Committee believes the proposed rule requires further explanation of what constitutes a "critical accounting estimate". Many of the terms used by the Commission to define critical accounting estimates are ambiguous or do not have a generally accepted meaning. For example, the proposed rule defines a "critical accounting estimate" as one which requires the company to make assumptions about matters that are "highly uncertain" at the time the estimate is made. It is unclear what the threshold is that makes an estimate "highly uncertain". Under the proposed rule, a company must also disclose different estimates that could reasonably have been used, or changes in estimates that are "reasonably likely to occur" from period to period and would have a material impact on the company's "financial presentation". The definition of "reasonably likely" is not clear on its face and should be clarified to provide companies with meaningful guidance on how to properly comply with the proposed rule. The meaning of the term "financial presentation" is extremely broad and could benefit from a clearer definition from the Commission.

We appreciate that the Commission opted for flexibility rather than adopting a rigid set of criteria out of a concern that no single definition would cover all circumstances. Nevertheless, the Committee believes that some quantitative guidelines would help assure uniformity and comparability of disclosure and enable issuers to better comply without creating a too formal, mechanistic approach, which we agree would undoubtedly produce skewed results in many cases. The Committee suggests that the Commission create quantitative guidelines, perhaps stating a particular minimum dollar and percentage level of effect a change in the estimate must have on a line item of the company's financial statements, such as operating income, interest expense, net profit or cash flow, in order to require disclosure as a critical accounting estimate. These guidelines could provide the framework for safe harbor protections based on the percentage impact the change in a critical accounting estimate would have on a particular line item. If the change was below the percentage stated in the rule, disclosure of that estimate would not be required. If an estimate subsequently became critical, its prior lack of disclosure by a company's management would then be protected by this safe harbor. An example of this approach is found in the definition of a "significant subsidiary" in Rule 1-02(w) of Regulation S-X.

The Commission has suggested disclosure of a company's top three to five critical accounting estimates and questioned whether there should be a maximum limit of seven; however, no specific guidance or formula is provided regarding how to determine these top estimates. Depending upon the type and size of the company, the financial statements might contain a large number of accounting estimates for which a company's management is responsible each quarter. The proposed rule, however, does not include sufficient guidance as to how a company's management should determine which of those estimates are the top 3 or 5 or 7 critical estimates within the meaning of the proposed rule. Moreover, companies will be exposed to potentially significant "hindsight" liability if an estimate not disclosed as critical subsequently proves erroneous and results in a material change in net income or another financial statement line item. It will be all too easy for the plaintiffs' bar to allege that the company should have disclosed the estimate and the very fact that its correction was material demonstrates that it was, in fact, critical.

Another concern associated with the proposed rule is that managements may not be able to isolate individual critical accounting estimates as neatly as is suggested in the examples. (We note that the example in the Release, which relates to warranty claims, treats copper prices as a critical estimate. However, the example does not treat the estimate of the expected number of warranty claims themselves as a critical accounting estimate, which, being something that management could influence, might be viewed as more significant than copper prices.) Many estimates that a company makes have varying effects on different line items or within a single line item. For example, interest rates may factor into many different estimates, but may affect each line item in substantially different ways, reducing one particular item but increasing another. Merely aggregating these interest rate variables may tend to obscure the important information rather than enlighten investors about the company's performance. It is also extremely difficult to segregate the values associated with one estimate without explaining their effect on other estimates, thereby further complicating the proposed disclosure. The Committee is concerned that, as drafted, there are simply too many varying factors for which disclosure might be required by the proposed rule.

The examples provided in the Release also do not take into account the large number of companies that operate many business units across multiple business segments. For those companies, the disclosure required would be much more complex and lengthy because of the extensive nature of their business operations. It is unclear from the release if the Commission intends to require segment by segment disclosure of three to five critical accounting estimates within each segment, which would be extremely costly and time consuming. We suggest that the Commission clarify this issue by limiting the required disclosure to three to five for a company taken as a whole.

Additionally, there may not exist a general or uniform standard by which accounting estimates are consistently made throughout an industry. Therefore, there may be no common denominator by which to judge the effect of critical accounting estimates on the financial statements of an individual company and, as a result, the disclosure will be rendered substantially less valuable.

a. Historical Disclosure Requirement

The Commission's proposal to require disclosure of changes in critical accounting estimates over the past three years would require companies, for years prior to the adoption of the rule, to reconstruct and disclose previous accounting estimates. Where financial statements of an acquired business are required by Section 3-05 of Regulation S-X, such a reconstruction may not be feasible for acquisitions that have already occurred. Moreover, since this information is not the type that has been disclosed in the past, disclosure of this nature would raise concerns regarding liability for disclosure of practices or results that occurred prior to the implementation of these new regulations. This amounts to an *ex post facto* application of the proposed rule with attendant liability inasmuch as it may suggest that previous years' disclosure were deficient. Further, unless a company's management, board members, and auditors continue to be the same as those at the time the prior financials were prepared, the current management, board and auditors may have considerable difficulty developing the required disclosures related to prior financials that reflect decisions of other persons. In the case of companies audited by Arthur Andersen and where management has been substantially replaced, compliance with the "look-back" application of the proposed rule may be impossible as a practical matter. The Committee, therefore, recommends that the proposed rule only be applied to the financials statements that are prepared after the adoption of the rule. This "forward-looking" application of the rule would be consistent with the SEC's intent to require current management to present its decisions with respect to accounting policies and estimates.

The Committee suggests that the requirement for the presentation of historical critical accounting estimates be phased-in after the final rule is adopted and pertain only to years beginning in the year after the implementation of the rule. Consideration should also be given to what type of disclosure would be required if prior years had been restated to reflect subsequent acquisitions accounted for as poolings of interest – previous accounting estimates of management of acquired entities should not be required in the registrant’s MD&A. We also suggest that the Commission consider the relevance of historical estimates for matters that are macroeconomic and beyond the control of management. The accuracy of estimates of matters such as interest rates or economic conditions are fully reflected in completed accounting periods and already must be discussed in MD&A. It should be remembered that while an estimate may be the basis of a future independent disclosure liability, even if the estimate is wrong, the financial statements may be unaffected. To disclose past estimates without a safe harbor is to impose new backward reaching liability not covered by the existing safe harbors for forward looking statements. Therefore, if disclosure of estimates for periods prior to the adoption of the proposed rule are to be required, the Committee proposes that the Commission create safe harbor protections for this type of information similar to those established for forward looking statements provided under Rule 175 of the Securities Act and Rule 3b-6 of the Exchange Act.

In the Release, the Commission states that the new instructions to the proposed rule would provide some examples of the type of forward looking statements that would be required in MD&A and would alert companies to consider the terms, conditions and scope of the existing safe harbors when drafting this disclosure. This language, however, leaves unclear the extent to which existing safe harbors will apply to the proposed disclosure and places the burden on the issuer to determine the extent of such protection. The Committee therefore urges the Commission to further clarify the application of existing safe-harbors for forward looking statements made in the proposed MD&A disclosure.

The Committee also believes it would be useful if the Commission provided a standard format for presentation, by providing specific guidance, like that provided in Item 305 of Regulation S-K, or by including specific examples of the desired format. In this way, a general practice or format for presentation of the required disclosure may develop, much like has occurred through the application of Item 305. This would apply to the disclosure of both historical and current information and would provide guidance as to the type of disclosure required under the proposed rule. This guidance would also help ease the comparison of disclosure among different companies.

b. Quantitative Disclosures

Another element of the proposed rule requires disclosure about the sensitivity of critical accounting estimates. The Release suggests that for each critical accounting estimate a company would discuss changes that would result either from (i) making reasonably possible, near-term changes to the most material assumptions underlying the estimate or (ii) using the end of the range of reasonably possible amounts which the company likely determined when formulating its recorded estimate. Specifically, the Commission's suggestion of using the end of the range of reasonably possible amounts as part of a sensitivity analysis may not prove useful since there is no readily available independent method for validating the plausibility of the range selected by management. In these circumstances, investors will therefore have a difficult time understanding the actual meaning of this presentation. Investors will not be aided in their investment decisions by the proposal unless they are able to make a meaningful comparison of the disclosures being provided. Since the methodology used by each company in developing its sensitivity analysis will not necessarily be disclosed, the results of a particular company's analysis may not be comparable across different companies within a specific industry. We suggest that the Commission review this aspect of the proposal in order to achieve comparable disclosure among registrants in comparable businesses.

The required disclosure of a sensitivity analysis of the application of different critical accounting estimates to a company's financial statements may also act to inhibit the freedom of management to create ranges from which estimates are devised. Managements that need to justify the estimation process may tailor the range presented in the MD&A so the estimate appears to be near the middle. In this way, management will provide itself with some protection against widely fluctuating actual results and may not accurately represent the ends of the range. In effect, the proposed rule may have the consequence of inadvertently chilling and thereby artificially inhibiting the estimation process.

c. Segment Reporting

Under the proposed rule, a company would have to specifically identify how critical accounting estimates affect each segment. While the Committee appreciates the need for disclosure of segment information if the segment estimates affect the company as a whole, nevertheless, it is unclear how management would determine when it must include, in addition to the presentation on a company-wide basis, a separate discussion of the critical accounting estimates made by management for each identified segment about which disclosure is otherwise required. More specific guidance from the Commission is required in order to determine when such analysis is appropriate. The impact of a particular estimate on the results of an individual line item for a segment might be material for that segment, but when examined as part of the overall performance of the company, this analysis might change.

As drafted, it is unclear from the text of the proposed rule if the maximum possible number of estimates would apply as a total across the entire company or on a per segment basis. If disclosure is required on a per segment basis in the same manner as required for the company as a whole, then as the number of segments and the number of estimates increases, the length of disclosure included in the MD&A would also grow. For example, if the discussion of one critical accounting estimate includes the impact on particular line items in the financial statements, a discussion of the assumptions behind the estimate as well as a sensitivity analysis, this type of disclosure could easily require a full page or more in the MD&A. If this type of disclosure is carried down to the segment level, and a company has three to five critical accounting estimates for the overall company and three to five in each segment, with five segments, then, based on the level of detail provided in the Commission's examples, the MD&A could have a discussion of critical accounting estimates in the range of 18-30 pages. The Committee doubts whether the benefit to be derived from this type of disclosure is commensurate with the additional time and cost associated with creating this type of disclosure. Therefore, the Committee suggests that the Commission provide further clarification of the required disclosure regarding critical accounting estimates on a segment basis.

III. Quarterly Updates

Companies may find it extremely difficult to update critical accounting estimates for material changes on a quarterly basis. The time commitments associated with complying with the proposed rule even on an annual basis will be substantial and may make quarterly updating impractical. The Committee is particularly concerned that audit committees will not have adequate time to discuss critical accounting estimate updates with management in the limited time between the end of the quarter and the filing of the Form 10-Q, particularly in the face of the Commission's proposed rules for shortening the time in which quarterly reports must be filed. The Committee urges the Commission to reconsider this requirement, at least for the initial annual reporting cycle after the effectiveness of the proposal.

IV. The Role of the Audit Committee and Auditor Examination of MD&A Disclosure Relating to Critical Accounting Estimates

The proposed rule would require a company to disclose in MD&A whether senior management has engaged in discussions with the audit committee about the company's critical accounting estimates. We believe that mere disclosure that such discussions occurred will not significantly improve the information provided to investors. We appreciate that the Commission hopes that this requirement will encourage the audit committee to have more detailed discussions with management regarding the company's critical accounting policies. The audit committee, however, may need additional help in reviewing critical accounting estimates in order to have meaningful discussions about those estimates with management. This may cause the audit committee to seek the advice of consultants, which may require additional time for the audit committee to discuss the estimates with these consultants and management and will increase the costs associated with this disclosure. This result may conflict with the Commission's desire to reduce the timing for filing Form 10-Ks and Form 10-Qs. Furthermore, independent accountants may have concerns about reviewing the MD&A due to potential liability associated with such a review.

The audit committee's concerns about liability may also affect communications between management and the audit committee. If the purpose of this provision is to encourage the involvement of the audit committee in the application of critical accounting policies, this requirement might be better mandated in the rules governing the audit committee and not under the guise of a disclosure requirement. Were the Commission to pass the proposed rule mandating a discussion with the audit committee, then, at a minimum, the Commission should articulate a standard establishing what constitutes reasonable discussion. We also suggest that the Commission provide guidance on what is not required of an audit committee – for example, absent extenuating circumstances, an audit committee would not be expected to retain additional consultants, but would be justified in relying upon the registrant's independent accountants and counsel. If the Commission does not articulate such a standard, then it is likely that the courts will develop these standards over time. Inevitably, this uncertainty and heightened risk of liability will make it increasingly difficult to attract qualified directors to serve on audit committees.

While current accounting standards, such as AT § 701, provide for an independent accountant's examination and review of MD&A, the Committee believes that such examinations or reviews rarely occur. Even if the proposed rules do not include a requirement that the new MD&A disclosure undergo an auditor examination similar to that enumerated in AT § 701, the Committee believes that the increased disclosure required by the proposed rule would result in companies seeking an accountant's examination or review of the company's MD&A, particularly if a company is preparing a registration statement or other type of offering document, regardless of whether such examination or review was specifically required. However, if an AT § 701 report is given, SAS 72 comfort letter coverage may not be given, since that "comfort" is not given on things that have been "reported upon". In the absence of clear standards articulating what must be done in this regard, underwriters might also begin requiring such an examination or a comfort letter covering the additional disclosure in the MD&A as a normal part of a securities offering in order to bolster their due diligence defense.

It is unclear whether accountants will be willing to take on the increased risks associated with a review of the MD&A, unless the Commission were to mandate it. When an independent accountant performs an audit of a company's financial statements, it then reports on those financial statements as a whole, and not on individual line items. Currently, there is no separate individual liability for the statements made in Note 1 of a company's financial statements but rather the financial statements are taken as a whole. The type of disclosure that would now be required within the MD&A could, in effect, create potential liability for each individual estimate made by management in the MD&A, which historically was only viewed in the context of the entire financial statements as a whole. We suggest the Commission address this issue.

As a result of the proposed rule, the audit committee and the company's auditors will almost certainly require more time to review the additional MD&A disclosure after it is prepared by management. These timing issues, combined with the proposed accelerated filing requirements recently put forth by the Commission, would hamper the ability of the audit committee to discuss critical accounting policies with management, particularly if this type of requirement were to apply to any quarterly update of critical accounting policies. The Committee, therefore, requests that the Commission reconsider this requirement, particularly as it applies to quarterly updating of the disclosure regarding critical accounting policies.

V. Initial Adoption of Accounting Policies

Under the proposed rule, a company will be required to disclose the initial adoption of an accounting policy when an event or transaction: (1) occurs for the first time; (2) was previously immaterial in its effect but becomes material; or (3) is clearly different in substance from previous events or transactions. This proposed disclosure raises several concerns and requires further clarification from the Commission. First, the proposed rule is not clear regarding the standard for materiality required for the disclosure of the initial adoption of accounting policies. Second, disclosure should not be required for the adoption of the only possible accounting policy available in a particular situation. If management has no discretion and the standard is set by the appropriate accounting professionals, investors would yield no benefit from this disclosure. Third, disclosure of changes in the underlying business and of material changes in or the initial adoption of material accounting policies is already required either in the company's financial statements or elsewhere in an offering document or a company's Exchange Act documents. In addition, if the disclosure regarding accounting policies currently required in Note 1 of the financial statements is inadequate, perhaps the intent of the Commission to improve the quality of information provided to investors would be better served by seeking changes in the requirements of Note 1 rather than those of MD&A. Furthermore, a requirement to again disclose this information in the MD&A would be duplicative while not necessarily improving the quality of the disclosure to the investing public.

It is unclear the extent to which investors would benefit from a discussion and comparison of the accounting policy adopted by the company's management to an alternative policy that management chose not to adopt or did not even seriously consider. If the disclosure regarding the initial adoption of this new policy is drafted correctly, it should include reasoning as to why management chose this policy. An analysis and comparison to other possible policies might serve only to promote the second guessing of management's decisions and increase potential liability without shedding light on the correctness of the policy chosen.

The Committee believes the Commission's suggestion to require a comparison of a new policy adopted by the company to policies used by other companies in the same industry may prove untenable. It may not be clear to a company's management what policies other companies are applying, particularly if there are several appropriate policies available under GAAP. Such disclosure would essentially amount to an additional immaterial disclosure which may have the effect of obscuring more material information rather than providing useful information to the reader. Such disclosure might damage a company's competitive advantage in a particular industry if the comparison of a company's accounting policies to others in the same industry reveals a company's operating plans and procedures. Companies should not be forced to disclose information as a result of the proposed rule regarding specific business practices (not merely accounting practices) that give them a competitive advantage. If, however, a company has put into effect a different, yet permissible, accounting policy that results in the company having substantially different results merely because of the application of this new policy rather than because of better operations, disclosure of such a practice would clearly benefit the investment community and should be required by the Commission.

VI. Foreign Private Issuers

Foreign private issuers may find it unduly difficult to comply with the proposed rule. Currently, foreign private issuers create their primary financial statements using local GAAP, International Accounting Standards or International Financial Reporting

Standards and then must complete a reconciliation to U.S. GAAP in order to register securities with the Commission. Under the proposed rules, the foreign private issuer must consider critical accounting estimates in connection with both its primary financial statements and its reconciliation to U.S. GAAP even if the disclosure of critical accounting estimates is not required in the primary financials statements. As a practical matter, this may impose United States disclosure requirements on foreign private issuers in their home countries, because these issuers might not want to have critical accounting estimates disclosed in the United States and not at home. By mandating these disclosure requirements on foreign private issuers without some modification, the proposed rule could act to discourage foreign private issuers from entering the U.S. financial markets rather than merely encouraging more thorough disclosure.

The proposed rule also states that foreign private issuers would generally be exempt from updating critical accounting estimates on more than an annual basis. However, if a foreign private issuer files a registration statement that must include interim period financial statements and related MD&A disclosure, it would be required to update the proposed MD&A disclosure in that document. If this were the case, foreign private issuers desiring to file a registration statement would face significantly more burdensome disclosure requirements. For these reasons, the Committee believes that the application of the proposed rule to foreign private issuers in this manner may act to further deter foreign private issuers from entering the U.S. markets. The Committee further believes that as part of phasing-in the proposed rule, it might be beneficial to postpone application of the rule to foreign private issuers until after the impact of the new rule on domestic issuers is clear and adequate precedent is available.

VII. Conclusion

The need for increased understanding by investors of the critical accounting estimates and underlying assumptions contained in a company's financial statements has become more pressing recently as the efficacy of companies' accounting practices have come under greater scrutiny. To the extent the proposal would improve the quality of the disclosure included in the MD&A through more detailed discussion about critical accounting policies, we believe the proposed rule, if modified to specifically tailor the required disclosure to those items that are material to investors, will help bolster the investors' confidence in a company's financial statements. MD&A is designed to let investors see an issuer through the eyes of its management. However, to the extent the proposal mandates unnecessarily detailed and lengthy disclosure and disclosure about scenarios that are less than likely to occur, we believe this type of disclosure would reduce, rather than enhance, confidence in MD&A.

The Committee commends the Commission for putting forth the Release and proposing new standards of disclosure in MD&A. It is the belief of the Committee that the investment community would be well served if the Commission gave additional consideration to specific elements of the proposed rule, as set forth in this letter.

Please note that Committee members Wayne Carlin of the United States Securities and Exchange Commission and David Jaffe of the National Association of Securities Dealers, Inc. did not participate in the preparation of this letter or the vote by the Committee to submit this letter to the Commission. In addition, this letter does not necessarily reflect the individual views of members of the Committee.

Members of the Committee would be pleased to answer any questions you might have regarding our comments, and to meet with the Staff if that would assist the Commission's efforts.

Respectfully Submitted,

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Charles M. Nathan, Chair of Committee on
Securities Regulation

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Matthew J. Mallow, Chair of the Committee
On Securities Regulation Drafting

Subcommittee

cc: Alan Beller, Director
Division of Corporation Finance
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