

example, the current MD&A rules require disclosure of:

- Information necessary to an understanding of the registrant's financial condition, changes in financial condition and results of operations;¹⁵
- Any known trends, demands, commitments, events or uncertainties that will result in, or that are reasonably likely to result in, the registrant's liquidity increasing or decreasing in any material way;¹⁶
- The registrant's internal and external sources of liquidity, and any material unused sources of liquid assets;¹⁷
- The registrant's material commitments for capital expenditures as of the end of the latest fiscal period;¹⁸
- Any known material trends, favorable or unfavorable, in the registrant's capital resources, including any expected material changes in the mix and relative cost of capital resources, considering changes between debt, equity and any off-balance sheet financing arrangements.¹⁹
- 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, the extent to which income was so affected.²⁰
- Significant components of revenues or expenses that should, in the company's judgment, be described in order to understand the registrant's results of operations;²¹
- 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.²²

Furthermore, Caterpillar's MD&A should have discussed various factors which contributed to the subsidiary's earnings, such as currency translation gains, export subsidies, interest income, and Brazilian tax loss carry-forwards, because such items were significant components of its revenues that should have been identified and addressed in order for a reader of the company's financial statements to understand Caterpillar's results of operations. *Id.*

¹⁵ See Item 303(a) of Regulation S-K [17 CFR 229.303(a)].

¹⁶ See Item 303(a)(1) of Regulation S-K [17 CFR 229.303(a)(1)].

¹⁷ *Id.*

¹⁸ See Item 303(a)(2)(i) of Regulation S-K [17 CFR 229.303(a)(2)(i)].

¹⁹ See Item 303(a)(2)(ii) of Regulation S-K [17 CFR 229.303(a)(2)(ii)].

²⁰ See Item 303(a)(3)(i) of Regulation S-K [17 CFR 229.303(a)(3)(i)].

²¹ *Id.*

²² See Item 303(a)(3)(iii) of Regulation S-K [17 CFR 229.303(a)(3)(iii)].

• Matters that will have an impact on future operations and have not had an impact in the past;²³ and

• Matters that have had an impact on reported operations and are not expected to have an impact upon future operations.²⁴

Accordingly, while only one item in our current MD&A rules specifically identifies off-balance sheet arrangements,²⁵ the other items clearly require disclosure of off-balance sheet arrangements if necessary to an understanding of a registrant's financial condition, changes in financial condition or results of operations. As discussed below, the amendments clarify disclosures that registrants must make with regard to off-balance sheet arrangements, require registrants to set apart disclosure relating to off-balance sheet arrangements in a designated section of MD&A and (except in the case of small business issuers) require tabular disclosure of aggregate contractual obligations.²⁶

II. Overview of Proposals, Comments and Amendments

A. Proposing Release

In November 2002, we published for comment proposals to require disclosure of a registrant's off-balance sheet arrangements in its MD&A.²⁷ To address the scope of the disclosure contemplated by the Sarbanes-Oxley Act, the proposals included a definition of the term "off-balance sheet arrangement" that covered a wide variety of arrangements. The proposed rules defined the term "off-balance sheet arrangement" as any transaction, agreement or other contractual arrangement to which an entity that is not consolidated with the registrant is a party, under which the registrant, whether or not a party to the

arrangement, has, or in the future may have:

- Any obligation under a direct or indirect guarantee or similar arrangement;
- A retained or contingent interest in assets transferred to an unconsolidated entity or similar arrangement;
- Derivatives, to the extent that the fair value thereof is not fully reflected as a liability or asset in the financial statements; or
- Any obligation or liability, including a contingent obligation or liability, to the extent that it is not fully reflected in the financial statements (excluding the footnotes thereto).

Because the Sarbanes-Oxley Act refers to off-balance sheet arrangements that "may" have a material future effect on the registrant, the proposed rules included a threshold for determining which off-balance sheet arrangements would have such an effect. In particular, the proposals would have required disclosure where the likelihood of either the occurrence of a future event implicating an off-balance sheet arrangement, or its material effect, was higher than remote. The proposed disclosure threshold departed from the existing MD&A threshold, under which a company must disclose information that is "reasonably likely" to have a material effect on financial condition, changes in financial condition or results of operations.²⁸

The proposals contained specific items designed to elicit comprehensive information about a registrant's off-balance sheet arrangements that would provide investors with a clear understanding of the registrant's business activities, financial arrangements and financial statements. To filter out disclosure of insignificant details, the proposals would have required disclosure of enumerated items only "to the extent necessary to an understanding of the registrant's off-balance sheet arrangements and their effect on financial condition, changes in financial condition and results of operations." The proposals would have required a registrant to disclose:

- The nature and business purpose of the registrant's off-balance sheet arrangements;
- The significant terms and conditions of the arrangements;
- The nature and amount of the total assets and of the total obligations and liabilities of an unconsolidated entity

²⁸ In a January 2002 Commission Statement, we indicated our view that "reasonably likely" is a lower disclosure threshold than "more likely than not." See Release No. 33-8056, FR-61 (Jan. 22, 2002) [67 FR 3746] (the "Commission Statement").

²³ See Instruction 3(A) to Item 303(a) of Regulation S-K [17 CFR 229.303(a)].

²⁴ See Instruction 3(B) to Item 303(a) of Regulation S-K [17 CFR 229.303(a)].

²⁵ See Item 303(a)(2)(ii) of Regulation S-K [17 CFR 229.303(a)(2)(ii)].

²⁶ The Sarbanes-Oxley Act exempts from section 401 investment companies registered under section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a-8). See Pub. L. 107-204 Sec. 405 [15 U.S.C. 7263]. Therefore, registered investment companies are excluded from the scope of the amendments. The amendments apply, however, to business development companies. Business development companies are defined in section 2(a)(48) of the Investment Company Act of 1940. See 15 U.S.C. 80a-2(a)(48). Business development companies are a category of closed-end investment companies that are not required to register under the Investment Company Act, but file Forms 10-K and 10-Q, and also include MD&A in their annual reports to shareholders.

²⁷ See Release No. 33-8144 (Nov. 4, 2002) [67 FR 68054].