

management is in the best position to monitor and assess those aspects of its business, it also is in the best position to provide clear explanations and analysis to investors. Our objectives are:

- To implement the legislative mandate in section 401(a) of the Sarbanes-Oxley Act;
- To provide investors with the information and analysis necessary to gain a more comprehensive understanding of the implications of a company's obligations and contingencies from off-balance sheet arrangements that are neither readily apparent, nor easily understood, from a reading of the financial statements alone; and
- To better inform investors of the short- and long-term impact of payments due under contractual obligations, from both on- and off-balance sheet activities, by presenting a complete picture in a single location. With a greater understanding of off-balance sheet arrangements and contractual obligations, investors should be better able to understand how a company conducts significant aspects of its business (including financing), to assess the quality of earnings and to understand the risks that are not apparent on the face of the financial statements.

### C. Regulatory Approach

We are adopting principles-based disclosure requirements that are bolstered by four specific disclosure items to provide basic information about off-balance sheet arrangements. The principle governing our regulatory approach is that registrants should disclose information to the extent that it is necessary to an understanding of its off-balance sheet arrangements and their effect on financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources. To militate against obscure disclosure, the amendments include four disclosure items that are designed to result in a focused and descriptive discussion of the registrant's material off-balance sheet arrangements. This approach attempts to balance the need for registrants to have flexibility when drafting financial disclosure with investors' needs for more transparency. While the amendments could be considered less prescriptive than the proposed rules, we believe that we have preserved the benefits to investors of the disclosure requirements for off-balance sheet arrangements.

Certain disclosures required by this amendment are already required by generally accepted accounting

principles.<sup>161</sup> The amendments are designed to work in concert with the disclosures required by generally accepted accounting principles to provide investors with a deeper, more comprehensive understanding of off-balance sheet arrangements employed by the registrant. Management is afforded the flexibility under the amendments to enhance the factual content contained in the financial statements with its perspective of how off-balance sheet arrangements are used in the context of the registrant's business.

### D. Benefits of the Amendments

The primary anticipated benefit of the amendments is to increase transparency of a registrant's financial disclosure. Current market events have evidenced a need to provide investors with a clearer understanding of how a company's off-balance sheet arrangements materially affect the financial statements and company performance.<sup>162</sup> The amendments are intended to enhance the utility of the disclosure in the MD&A section by providing more information, including management's analysis, of off-balance sheet arrangements. In addition, the tabular disclosure of contractual obligations is designed to provide investors with an understanding of the liquidity and capital resource need and demands in short- and long-term time horizons.

By making information about off-balance sheet arrangements and contractual obligations available and more understandable, the amendments will benefit investors both directly and indirectly through the financial analysts and the credit rating agencies whose analyses investors consider.<sup>163</sup> In addition, the amendments should benefit investors because the enumerated disclosure will likely be more comparable across all firms and consistent over time. Greater transparency will thus enable investors to make more informed investment

decisions and to allocate capital on a more efficient basis.

### E. Costs of Amendments

We estimate that the amendments will impose a disclosure requirement on approximately 9,850 public companies.<sup>164</sup> We estimate that the disclosure will involve multiple parties, including in-house preparers, senior management, in-house counsel, outside counsel, outside auditors, and audit committee members. One commenter, commenting on the types of expenses, believed that companies would incur significant legal, accounting and internal costs (including collection and monitoring systems) in order to comply with the proposed disclosure.<sup>165</sup> For purposes of the Paperwork Reduction Act,<sup>166</sup> we estimated that company personnel would spend approximately 366,337 hours per year (37 hours per company) to prepare, review and file the proposed disclosure. Based on our estimated cost of in-house staff time, we estimated that the PRA hour-burden would translate into an approximate cost of \$45,792,000 (\$5,000 per company).<sup>167</sup> We also estimated that companies would spend approximately \$44,795,000 (\$5,000 per company) on outside professionals to comply with the disclosure.<sup>168</sup> In response to our request for comment, one commenter estimated the annual cost for a large multinational company to be about \$2 million.<sup>169</sup> One commenter noted that, in view of the limited number of public companies that may have failed to provide disclosures, it had significant reservations about whether the additional cost of regulation is justified.<sup>170</sup>

We believe the amendments will not substantially increase the costs to collect the information necessary to prepare the disclosure. This information should largely be readily available from each company's books and records. Since management should be fully apprised of off-balance sheet arrangements and contractual

<sup>161</sup> See FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* (Nov. 2002); FASB Interpretation No. 46, *Consolidation of Variable Interest Entities* (Jan. 2003); and FASB SFAS No. 129, *Disclosure of Information about Capital Structure* (Feb. 1997).

<sup>162</sup> See, e.g., Paquita Y. Davis-Friday et al., *The Value Relevance of Financial Statement Recognition vs. Disclosure: Evidence from SFAS No. 106*, 74 *The Accounting Review* 403 (Oct. 1999).

<sup>163</sup> See, e.g., Kent L. Womack, *Do Brokerage Analysts' Recommendations have Investment Value?* 51 *Journal of Finance* 137 (1996). See also, R. Mear and M. Firth, *Risk Perceptions of Financial Analysts and the Use of Market and Accounting Data*, 18 *Accounting and Business Research* 335 (1988).

<sup>164</sup> We estimate that about 80% of the number of registrants who filed annual reports last year will provide the disclosure.

<sup>165</sup> See, e.g., the letter of Pfizer.

<sup>166</sup> 44 U.S.C. 3501 et seq.

<sup>167</sup> We estimate the average hourly cost of in-house personnel to be \$125. This cost estimate is based on data obtained from *The SIA Report on Management and Professional Earnings in the Securities Industry* (Oct. 2001).

<sup>168</sup> To derive our estimates for the Paperwork Reduction Act, we multiplied the number of filers for each form by the incremental hours per form. The portion of the product carried by the company is reflected in hours and the portion carried by outside professionals is reflected as a cost.

<sup>169</sup> See, e.g., the letter of Pfizer.

<sup>170</sup> See, e.g., the letter of KPMG.