

their disclosure so that the most important information is most prominent;

- Companies should avoid unnecessary duplicative disclosure that can tend to overwhelm readers and act as an obstacle to identifying and understanding material matters; and
- Many companies would benefit from starting their MD&A with a section that provides an executive-level overview that provides context for the remainder of the discussion.

We also emphasize the following points regarding focus and content:

- In deciding on the content of MD&A, companies should focus on material information and eliminate immaterial information that does not promote understanding of companies' financial condition, liquidity and capital resources, changes in financial condition and results of operations (both in the context of profit and loss and cash flows);⁵
- Companies should identify and discuss key performance indicators, including non-financial performance indicators, that their management uses to manage the business and that would be material to investors;
- Companies must identify and disclose known trends, events, demands, commitments and uncertainties that are reasonably likely to have a material effect on financial condition or operating performance;⁶ and
- Companies should provide not only disclosure of information responsive to MD&A's requirements, but also an analysis that is responsive to those requirements that explains management's view of the implications and significance of that information and that satisfies the objectives of MD&A.

C. Impact of Increased Amounts of Information Available to Companies

Companies have access to and use substantially more detailed and timely information about their financial condition and operating performance than they did when our MD&A

⁵ In this release we sometimes use the term "financial condition and operating performance" to refer to the required subjects of MD&A of financial condition, liquidity and capital resources, changes in financial condition and results of operations (both in the context of profit and loss and cash flows).

⁶ Note 27 to the 1989 Release states, "MD&A mandates disclosure of specified forward-looking information, and specifies its own standards for disclosure—i.e., reasonably likely to have a material effect. The specific standard governs the circumstances in which Item 303 requires disclosure. The probability/magnitude test for materiality approved by the Supreme Court in *Basic v. Levinson*, 108 S.Ct. 978 (1988), is inapposite to Item 303 disclosure."

requirements initially were introduced or when we last provided general interpretive guidance.⁷ Some of this information is itself non-financial in nature, but bears on companies' financial condition and operating performance. The increased availability of information is relevant to companies in preparing MD&A for the following reasons:

- First, companies must evaluate an increased amount of information to determine which information they must disclose. In doing so, companies should avoid the unnecessary information overload for investors that can result from disclosure of information that is not required, is immaterial, and does not promote understanding.

- Second, in identifying, discussing and analyzing known material trends and uncertainties, companies are expected to consider all relevant information, even if that information is not required to be disclosed.

D. Liquidity and Capital Resources

We devote a separate section of this release to disclosure in MD&A regarding liquidity and capital resources. In that section, we emphasize the need for attention to disclosure of cash requirements and sources of cash. We believe that:

- Companies should consider enhanced analysis and explanation of the sources and uses of cash and material changes in particular items underlying the major captions reported in their financial statements, rather than recitation of the items in the cash flow statements;
- Companies using the indirect method⁸ in preparing their cash flow

⁷ See, e.g., *Improving Business Reporting—A Customer Focus; Meeting the Information Needs of Investors and Creditors*, Comprehensive Report of the Special Committee on Financial Reporting, American Institute of Certified Public Accountants (AICPA) (1994) ("Jenkins Report").

⁸ In Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) No. 95, *Statement of Cash Flows* (Nov. 1987), the FASB allowed the indirect method of reporting net cash flow from operating activities by adjusting net income to reconcile it to net cash flow from operating activities. Under that method, the major classes of operating cash receipts and payments are determined indirectly by determining the change in asset and liability accounts that relate to operating income. However, in SFAS 95, the FASB encouraged companies to use the direct method of reporting net cash flow from operating activities rather than the indirect method. The direct method reports net cash flow from operations by summing major classes of gross cash receipts, such as customer payments, and gross cash payments, such as cash paid to employees. The direct method also requires a reconciliation of net income to net cash flow from operating activities. The FASB gave its opinion that the direct method is "the more comprehensive and presumably more useful approach."

statements should pay particular attention to disclosure and analysis of matters that are not readily apparent from their cash flow statements; and

- Companies also should consider whether their MD&A should include enhanced disclosure regarding debt instruments, guarantees and related covenants.

E. Critical Accounting Estimates

Finally, we have included a separate section in this release regarding accounting estimates and assumptions that may be material due to the levels of subjectivity and judgment necessary to account for highly uncertain matters or the susceptibility of such matters to change, and that have a material impact on financial condition or operating performance. Companies should consider enhanced discussion and analysis of these critical accounting estimates and assumptions that:

- Supplements, but does not duplicate, the description of accounting policies in the notes to the financial statements; and

- Provides greater insight into the quality and variability of information regarding financial condition and operating performance.

F. Effect on Prior Commission Statements

This release does not modify existing legal requirements or create new legal requirements. Rather, we intend this release to assist companies in preparing MD&A by providing interpretive guidance and, in some cases, providing additional guidance in areas that the Commission has addressed previously. We do not believe that the guidance in this release conflicts with prior Commission guidance, nor is it our intention to alter any prior Commission guidance.

II. Background

The following is a chronology of certain prior Commission action regarding MD&A:

While this release refers primarily to U.S. GAAP, the underlying events and circumstances described in the release ordinarily will be applicable to foreign private issuers and should be discussed to the extent material. Consistent with the Instructions to Form 20-F, however, companies using that form should focus on the primary financial statements in their discussion and analysis in Item 5 (Operative and Financial Review Prospects). Also, companies are required to discuss in Item 5 of Form 20-F any aspects of the differences between foreign and U.S. GAAP that they believe are necessary for an understanding of the financial statements as a whole. See Instruction 2 to Item 5 of Form 20-F [17 CFR 249.220f].