

financial and non-financial information available to them, and whether or not the available information itself is required to be disclosed. This information, over time, may reveal a trend or general pattern in activity, a departure or isolated variance from an established trend, an uncertainty, or a reasonable likelihood of the occurrence of such an event that should be disclosed.

One of the principal objectives of MD&A is to provide information about the quality and potential variability of a company's earnings and cash flow, so that readers can ascertain the likelihood that past performance is indicative of future performance. Ascertaining this indicative value depends to a significant degree on the quality of disclosure about the facts and circumstances surrounding known material trends and uncertainties in MD&A. Quantification of the material effects of known material trends and uncertainties can promote understanding. Quantitative disclosure should be considered and may be required to the extent material if quantitative information is reasonably available.

As discussed in the 1989 Release, the disclosures required to address known material trends and uncertainties in the discussion and analysis should not be confused with optional forward-looking information. Not all forward-looking information falls within the realm of optional disclosure. In particular, material forward-looking information regarding known material trends and uncertainties is required to be disclosed as part of the required discussion of those matters and the analysis of their effects.³⁸ In addition, forward-looking information is required in connection with the disclosure in MD&A regarding off-balance sheet arrangements.³⁹

4. Focus on Analysis

MD&A requires not only a "discussion" but also an "analysis" of known material trends, events, demands, commitments and uncertainties. MD&A should not be merely a restatement of financial

statement information in a narrative form. When a description of known material trends, events, demands, commitments and uncertainties is set forth, companies should consider including, and may be required to include, an analysis explaining the underlying reasons or implications, interrelationships between constituent elements, or the relative significance of those matters.

Identifying the intermediate effects of trends, events, demands, commitments and uncertainties alone, without describing the reasons underlying these effects, may not provide sufficient insight for a reader to see the business through the eyes of management. A thorough analysis often will involve discussing both the intermediate effects of those matters and the reasons underlying those intermediate effects. For example, if a company's financial statements reflect materially lower revenues resulting from a decline in the volume of products sold when compared to a prior period, MD&A should not only identify the decline in sales volume, but also should analyze the reasons underlying the decline in sales when the reasons are also material and determinable. The analysis should reveal underlying material causes of the matters described, including for example, if applicable, difficulties in the manufacturing process, a decline in the quality of a product, loss in competitive position and market share, or a combination of conditions.

Similarly, where a company's financial statements reflect material restructuring or impairment charges, or a decline in the profitability of a plant or other business activity, MD&A should also, where material, analyze the reasons underlying these matters, such as an inability to realize previously projected economies of scale, a failure to renew or secure key customer contracts, or a failure to keep downtime at acceptable levels due to aging equipment. Whether favorable or unfavorable conditions constitute or give rise to the material trends, demands, commitments, events or uncertainties being discussed, the analysis should consist of material substantive information and present a balanced view of the underlying dynamics of the business.

If there is a reasonable likelihood that reported financial information is not indicative of a company's future financial condition or future operating performance due, for example, to the levels of subjectivity and judgment necessary to account for highly uncertain matters and the susceptibility of such matters to change, appropriate

disclosure in MD&A should be considered and may be required. For example, if a change in an estimate has a material favorable impact on earnings, the change and the underlying reasons should be disclosed so that readers do not incorrectly attribute the effect to operational improvements. In addition, if events and transactions reported in the financial statements reflect material unusual or non-recurring items, aberrations, or other significant fluctuations, companies should consider the extent of variability in earnings and cash flow, and provide disclosure where necessary for investors to ascertain the likelihood that past performance is indicative of future performance. Companies also should consider whether the economic characteristics of any of their business arrangements, or the methods used to account for them, materially impact their results of operations or liquidity in a structured or unusual fashion, where disclosure would be necessary to understand the amounts depicted in their financial statements.

IV. Liquidity and Capital Resources

Our rules require companies to provide disclosure in the related categories of liquidity and capital resources.⁴⁰ This information is critical to an assessment of a company's prospects for the future and even the likelihood of its survival.⁴¹ A company is required to include in MD&A the following information, to the extent material:

- Historical information regarding sources of cash and capital expenditures;
- An evaluation of the amounts and certainty of cash flows;
- The existence and timing of commitments for capital expenditures and other known and reasonably likely cash requirements;
- Discussion and analysis of known trends and uncertainties;
- A description of expected changes in the mix and relative cost of capital resources;
- Indications of which balance sheet or income or cash flow items should be considered in assessing liquidity; and
- A discussion of prospective information regarding companies' sources of and needs for capital, except where otherwise clear from the discussion.⁴²

⁴⁰ See Item 303(a)(1) and (2) of Regulation S-K [17 CFR 229.303(a)(1) and (2)].

⁴¹ See January 2002 Release; 2003 Off-Balance Sheet Release.

⁴² See 1989 Release, Part III.C. See also Item 303(a)(1) and (2) of Regulation S-K [17 CFR

³⁸ See 1989 Release, Part III.B.

³⁹ In connection with our adoption of the off-balance sheet arrangements disclosure requirements, we eliminated a portion of the instructions in Item 303 of Regulation S-K that stated that registrants were not required to provide forward-looking information. Deleting that portion of the instructions did not affect requirements to provide forward-looking information in other circumstances where required or reduce the availability of any safe harbor for forward-looking information. See also 2003 Off-Balance Sheet Release. See Securities Act Section 27A [15 U.S.C. 77z-2], Securities Act Rule 175 [17 CFR 230.175], Exchange Act Section 21E [17 U.S.C. 78u-5], and Exchange Act Rule 3b-6 [17 CFR 240.3b-6].