

SARBANES-OXLEY UPDATE***Disclosure of Off-Balance Sheet Arrangements and Aggregate Contractual Obligations***

On January 22, 2003, the SEC adopted rule amendments to require an issuer to provide an explanation of its off-balance sheet arrangements in a separately captioned subsection of the MD&A contained in the issuer's disclosure documents.¹ In addition, the amendments also require issuers (other than small business issuers) to provide an overview of certain known contractual obligations in a tabular format.

The off-balance sheet disclosure requirements are effective for registration statements, annual reports and proxy or information statements that are required to include financial statements for fiscal years ending on or after June 15, 2003. The table of contractual obligations must be included in those disclosure documents that are required to include financial statements for the fiscal year ending on or after December 15, 2003.

What is an "off-balance sheet arrangement"?

The amendments define an "off-balance sheet arrangement" as any transaction, agreement or other contractual arrangement to which an entity that is not consolidated with the issuer is a party, under which the issuer, whether or not a party to the arrangement, has, or in the future may have:

- any obligation under certain **guarantee contracts** (with certain exceptions, characteristics identified in paragraph 3 of FASB Interpretation No. 45) (e.g., financial standby letter of credit, performance guarantee, indemnification agreement as to adverse judgment in a lawsuit or keepwell agreement);
- a **retained or contingent interest in assets transferred** to an unconsolidated entity or similar arrangement that serves as credit, liquidity or market risk support to that entity for such assets (e.g., a subordinated retained interest in a pool of receivables transferred to an unconsolidated entity);
- any obligation including a contingent obligation, under a contract that would be accounted for as a **derivative instrument**, except that it is both indexed to the issuer's own stock and classified in stockholder's equity in the issuer's statement of financial position, and therefore excluded from the scope of FASB Statement of Financial Accounting Standards No. 133 pursuant to paragraph 11(a) of that Statement, or with respect to a non-U.S. GAAP issuer, classified in stockholder's equity, or not reflected, in the issuer's statement of financial position; or
- any obligation, including a contingent obligation, arising out of a **variable interest** (as referenced in FASB Interpretation No. 46) in an unconsolidated entity that is held by, and material to, the issuer where such entity provides financing, liquidity, market risk or credit risk support to, or engages in leasing, hedging or research and development services with, the issuer.

What is the disclosure threshold for off-balance sheet arrangements?

A "reasonably likely" test applies. The amendments require disclosure of off-balance sheet arrangements that **have or are reasonably likely to have a current or future effect** on the issuer's financial condition, changes in financial condition, revenues or expenses, results of operation, liquidity, capital expenditures or capital resources. The focus is on material off-balance sheet arrangements and their material effects.

In determining whether disclosure is required, management must first identify and critically analyze the issuer's off-balance arrangements, including guarantee contracts, retained or contingent interests, derivative instruments and variable interests. Management must then assess the likelihood of the occurrence of any known trend, demand, commitment, event or uncertainty that could affect an off-balance sheet arrangement.

- If management concludes that the known trend, demand, commitment, event or uncertainty is not reasonably likely to occur, then no disclosure is required.
- If management cannot make that determination, it must evaluate objectively the consequences of the known trend, demand, commitment, event or uncertainty on the assumption it will come to fruition.
- Disclosure is then required unless management determines that a material effect on the issuer's financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources is "not reasonably likely" to occur.

What is the scope of the disclosure requirement?

The disclosure is a principles-based approach. The issuer is required to disclose information to the extent that it is necessary to provide investors with a clear understanding of the issuer's material off-balance sheet arrangements and their material effects on financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources. The amendments contain the following four specific disclosure items to bolster the principles-based approach:

- the nature and business purpose of the issuer's off-balance sheet arrangements;
- the importance of the off-balance sheet arrangements to the issuer for liquidity, capital resources, market risk or credit risk support or other benefits;
- the financial impact of the arrangements on the issuer (e.g., revenues, expenses, cash flows or securities issued) and the issuer's exposure to risk as a result of the arrangements (e.g., retained interests or contingent interest); and
- known events, demands, commitments, trends or uncertainties that affect the availability or benefits to the issuer of material off-balance sheet arrangements.

In addition, as with other principles-based disclosure requirements, the issuer is to provide other information that it believes is necessary for an understanding of its off-balance arrangements and their material effect on the issuer.

While there is no requirement to disclose the nature and amount of the total assets and total obligations of the unconsolidated entity that conducts off-balance sheet activities on behalf of the issuer, it may be necessary for the issuer, in fulfilling its requirements to explain the nature and business purpose of an off-balance sheet arrangement, to disclose the nature and amount of the assets transferred to the unconsolidated entity.

Issuers are to aggregate off-balance sheet arrangements in groups or categories that provide information in an efficient and understandable manner and avoid repetition and disclosure of immaterial information.

The SEC's policy regarding MD&A disclosure of preliminary negotiations also applies with respect to off-balance sheet arrangements. Therefore, the amendments include an instruction that no obligation to disclose an off-balance sheet arrangement will arise until an unconditionally binding definitive agreement, subject only to customary closing conditions, exists, or if there is no such agreement, when settlement of the transaction occurs.

What information must be disclosed in tabular format?

Issuers (other than small business issuers) will be required to disclose, in a tabular format, the amount of payments under specified contractual obligations, aggregated by category of contractual obligation, for specified time periods. The information is to be as of the latest fiscal year and balance sheet date and the table should be in substantially the same form as follows:

Contractual Obligations	Payments due by period				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
[Long-Term Debt]					
[Capital Lease Obligations]					
[Operating Leases]					
[Purchase Obligations]					
[Other Long-Term Liabilities Reflected on the Registrant's Balance Sheet under GAAP]					
Total					

To provide flexibility for company-specific disclosure, the amendments allow a registrant to disaggregate the specified categories by using other categories suitable to its business, but the table must include all of the obligations that fall within specified categories. In addition, the table should be accompanied by footnotes necessary to describe material contractual provisions or other material information, including any material termination or renewal provisions, to the extent necessary for an understanding of the timing and amount of the contractual obligations in the table.

The first three categories of contractual obligations are defined by reference to the relevant U.S. GAAP accounting pronouncements under which the issuer prepares its primary financial statements. The amendments define a “purchase obligation” to mean: “an agreement to purchase goods or services that is enforceable and legally binding on the registrant and that specifies all significant terms, including: fixed or minimum quantities to be purchased; fixed, minimum or variable price provisions; and the approximate timing of the transaction.”

To eliminate unnecessary repetition, an issuer may include within its MD&A a cross-reference to information in the footnotes to the financial statements. However, the quality of the discussion of off-balance sheet arrangements must not be diminished as a result of including a cross reference.

Do the amendments apply to foreign private issuers?

The amendments apply to foreign private issuers that file annual reports on Form 20-F or on Form 40-F. However, they do not apply to Form 6-K reports submitted by foreign private issuers to provide copies of materials required to be made public in their home jurisdictions.

To identify the types of arrangements that are subject to disclosure, a foreign private issuer must assess its guarantee contracts and variable interests pursuant to U.S. GAAP. Those issuers whose primary financial statements are prepared in accordance with non-U.S. GAAP should include in their MD&A a discussion of the reconciliation to U.S. GAAP, and any differences between foreign and U.S. GAAP, if it would be necessary to an understanding of the financial statements as a whole.

Will there be a safe-harbor for forward-looking statements?

The amendments provide for a safe-harbor for forward-looking information within the meaning of Section 27A of the Securities Act and 21E of the Exchange Act. The SEC urges companies to tailor the required cautionary language to the specific forward-looking statement being made.

For more information, please contact any of the following Jenner & Block attorneys:

Robert S. Osborne	rosborne@jenner.com	David R. Bowman	dbowman@jenner.com
Jerry J. Burgdoerfer	jburgdoerfer@jenner.com	Bobby J. Hollis II*	bhollis@jenner.com
Charles J. McCarthy	cmccarthy@jenner.com	Tobias L. Knapp*	tknapp@jenner.com
Robert Z. Slaughter	rslaughter@jenner.com	David M. Neville	dneville@jenner.com
John E. Welch*	jwelch@jenner.com	Edward G. Quinlisk	equinlisk@jenner.com
Thomas A. Monson	tmonson@jenner.com	Jill R. Sheiman	jsheiman@jenner.com
Scott J. Moore	smoore@jenner.com	Michael D. Thompson	mthompson@jenner.com
Thaddeus J. Malik	tmalik@jenner.com	Joseph A. Warburton	jwarburton@jenner.com
Donald E. Batterson	dbatterson@jenner.com	Cari M. Weber	cweber@jenner.com

All attorneys may be contacted by phone at 312-222-9350, except * at 202-639-6000.

Endnotes

¹ SEC Release Nos. 33-8182; 34-47264; FR-67 International Series Release No. 1266. The amendments affect Item 303 of Regulation S-K and Regulation S-B, Item 5 of Form 20-F and General Instruction B of Form 40-F under the Securities Exchange Act.