

April 24, 2000

Jonathan G. Katz, Secretary,
Securities and Exchange Commission,
450 Fifth Street, N.W., Stop 6-9
Washington, D.C. 20549.

Re: Supplementary Financial Information – File No. S7-03-00

Dear Mr. Katz:

The Federal Regulation Committee of the Securities Industry Association (“SIA”)¹ is pleased to submit this response to proposed changes to Item 302 of Regulation S-K. We salute the Commission’s efforts to address concerns about earnings management, as well as the Commission’s goal of providing investors with more transparent and detailed financial reporting. We strongly support both of these goals.

While the objectives of the proposed changes to Item 302 are praiseworthy, in at least two key respects we are very concerned that that some of the disclosures called for will unintentionally but seriously harm public companies and their shareholders, and will discourage good accounting practices. In order for the proposed changes to work beneficially for shareholders, it must be modified to avoid the following problems:

1. Litigation Loss Accruals. The requirement that a company disclose loss accruals related to probable losses from pending litigation would greatly weaken a firm’s ability to responsibly manage its litigation. The problem with the rule is that it would

¹ SIA brings together the shared interests of more than 740 securities firms to accomplish common goals. SIA member-firms (including investment banks, broker-dealers and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. The U.S. securities industry manages the accounts of more than 50 million investors directly and tens of millions of investors indirectly through corporate, thrift and pension plans. The industry generates more than \$300 billion of revenues yearly in the U.S. economy and employs more than 600,000 individuals. (More information about SIA is available on its home page: <http://www.sia.com>.)



require a separate schedule showing aggregate litigation reserves, with detail of additions and deductions for the period. Accompanying the schedule would be textual disclosure of "the nature of any changes in the assumptions used in estimating the amount...." This would generally make it easy for an opposing litigant to determine the amount set aside as a reserve in major cases.

Providing opposing litigants with this type of information would seriously harm a firm's litigation posture. Specifically, armed with this figure, opposing litigants would insist on the reserved amount as the starting point for settlement negotiations. Thus, a figure that was calculated as a company's "bottom line" would instead be a starting point, and the company's ability to settle the case on the most favorable terms for its shareholders would be harmed.

This disclosure would also devastate a firm's litigation position because the materials and analysis leading to the reserve calculation would probably be discoverable in the pending litigation. Today these materials are normally protected from discovery by the attorney-client and work product privileges because the reserve calculations that they support are not publicly disclosed or shared with an outside party (other than the firm's auditors, which does not waive applicable privilege). However, under the proposed approach these materials would underlie a public disclosure, and therefore these privileges would not apply. Moreover, statements about the firm's internal view of the litigation could be admissible into evidence as admissions, further weakening the firm's position as a defendant or a plaintiff.

All of these factors will give companies strong incentives to accrue the lowest possible number, and to support that calculation with extremely guarded and incomplete assessments of their litigation posture. This will result in loss accruals for litigation becoming less reliable. The net effect is that public accounting will be weakened, without any benefit to the Commission's concerns about earnings management.

2. Loss Accruals Related to Tax Matters. Similar concerns exist regarding loss accruals for tax matters. By disclosing the amount accrued over a particular tax strategy, a company might feel inhibited from pursuing legal tax minimization strategies if there is any concern at all about its interpretation of ambiguities in the applicable tax code. Companies may also be concerned about disclosing their tax strategies to competitors. Again, shareholders would not be well-served.

We wish to emphasize that we are not objecting in any way to inclusion of litigation or tax-related reserves as part of a firm's contingent liabilities, to be reported without identification in its accrued liabilities. Auditors are required to evaluate the adequacy of accruals for contingencies, and to attest that they are in accordance with generally accepted accounting principles, and the Commission can and should investigate any failures in this audit function. However, disclosures from which it can be derived how much has been reserved for a particular case is problematic for the reasons noted



above, and is of no particular use to shareholders. We believe that current disclosure requirements should continue to govern in these sensitive areas, primarily Statement of Financial Accounting Standards No. 5, *Accounting for Contingencies*.

Conclusion

Thank you for providing SIA with the opportunity to comment on the proposed changes to Item 302 of Regulation S-K. We hope that the comments offered above will help the Commission to craft the rule so that it more effectively address the serious issue of improper manipulation of financial results without unintentional and harmful collateral consequences. If we can be of further assistance, please do not hesitate to contact the undersigned, or George R. Kramer of the SIA staff at 202/296-9410.

Sincerely,

Joanne T. Marren
Chair
Federal Regulation Committee

James A. Tricarico, Jr.
President, SIA Compliance and Legal
Division

Cc: The Honorable Arthur Levitt, Chairman
The Honorable Norman S. Johnson, Commissioner
The Honorable Isaac C. Hunt, Jr., Commissioner
The Honorable Paul R. Carey, Commissioner
The Honorable Laura S. Unger, Commissioner
Lynn E. Turner, Chief Accountant
John W. Albert, Associate Chief Accountant
Richard L. Rodgers, Professional Accounting Fellow
Louise M. Dorsey, Assistant Chief Accountant