U.S. Securities and Exchange Commission

SEC STAFF REPORT ON OFF-BALANCE SHEET ARRANGEMENTS, SPECIAL PURPOSE ENTITIES AND RELATED ISSUES

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Washington, D.C., June 15, 2005 - The Securities and Exchange Commission announced today the release of a staff report prepared by the Office of the Chief Accountant, the Office of Economic Analysis and the Division of Corporation Finance on off-balance sheet arrangements, special purpose entities and related issues. The report was prepared pursuant to Section 401 (c) of the Sarbanes-Oxley Act of 2002. As required by that Act, the report has been submitted to the President, the Committee on Banking, Housing and Urban Affairs of the Senate, and the Committee on Financial Services of the House of Representatives. The staff report includes an analysis of the filings of issuers as well as an analysis of pertinent U.S. generally accepted accounting principles and Commission disclosure rules. The report describes the staff's study, details its findings, and provides recommendations.

Chairman Donaldson said, "The staff report we are releasing today sets forth important principles for long-term improvements to financial reporting. Improving financial reporting to better reflect these principles and goals will require the commitment and support of standard-setters, as well as reporting companies, auditors and investors. I also should note that more than 100 of our staff participated in the completion of the study and report and I sincerely appreciate their efforts."

The staff took a broad approach to the scope of the report by including a review of a range of topics with potential off-balance sheet implications, including consolidation issues, transfers of financial assets with continuing involvement, retirement arrangements, contractual obligations, leases, contingent liabilities and derivatives, as well as a discussion of special purpose entities (SPEs).

The report identifies several goals for those involved in the financial reporting community, including efforts to

- discourage transactions and transaction structures motivated primarily and largely by accounting and reporting considerations, rather than economics;
- expand the use of objectives-oriented standards;

- improve the consistency and relevance of disclosures; and
- focus financial reporting on communication with investors, rather than just compliance with rules.

Donald T. Nicolaisen, SEC Chief Accountant, said "The report identifies improvements that have occurred in financial reporting since passage of the Sarbanes-Oxley Act and, importantly, it offers recommendations for further improvements designed to increase both the transparency and usefulness of the balance sheet. Greater transparency can be achieved in some areas simply by reducing accounting choices and complexity. Since the events leading to passage of the Sarbanes-Oxley Act, we have made progress in improving financial reporting to investors, but more can still be done. I'm hopeful that this report will help focus efforts on further ways to improve transparency."

Alan Beller, Director of the Division of Corporation Finance, said, "This report points up the challenges faced by issuers in communicating financial information important to investment decisions of investors. I believe that even without rule changes issuers can do a better job of communicating in a transparent manner information and analysis regarding their off-balance sheet activities and the impact on their income, cash flow and balance sheets."

Chester Spatt, SEC Chief Economist, said "I expect that this comprehensive report will serve as an important building block in our continuing march toward greater transparency in financial reporting, which is a key ingredient to maintaining the efficiency of our financial markets as well as protecting investors."

The report also provides recommendations for certain changes in accounting and reporting requirements, each of which complement one or more of the goals mentioned above

- The staff recommends the accounting guidance for defined-benefit pension plans and other post-retirement benefit plans be reconsidered. The trusts that administer these plans are currently exempt from consolidation by the issuers that sponsor them, effectively resulting in the netting of assets and liabilities in the balance sheet. In addition, issuers have the option to delay recognition of certain gains and losses related to the retirement obligations and the assets used to fund these obligations.
- The staff recommends that the accounting guidance for leases be reconsidered. The current accounting for leases takes an "all or nothing" approach to recognizing leases on the balance sheet. This results in a clustering of lease arrangements such that their terms approach, but do not cross, the "bright lines" in the accounting

guidance that would require a liability to be recognized. As a consequence, arrangements with similar economic outcomes are accounted for very differently.

- The staff recommends the continued exploration of the feasibility of reporting all financial instruments at fair value.
- The staff recommends that the Financial Accounting Standards Board continue its work on the accounting guidance that determines whether an issuer would consolidate other entities-including SPEs-in which the issuer has an ownership or other interest.
- The staff believes that, in general, certain disclosures in the filings of issuers could be better organized and integrated.

The full text of the staff study can be found at www.sec.gov/news/studies/soxoffbalancerpt.pdf.

http://www.sec.gov/news/press/2005-91.htm
