

Client Alert: SEC Proposes New Rules on Use of “Pro Forma” Financial Information and Requiring Filing of Earnings Releases on Form 8-K

A. Introduction

On November 4, 2002, the SEC released proposed rules that would implement §401(b) of the Sarbanes-Oxley Act of 2002 (SOA) regarding the use of “pro forma” financial information in SEC filings and other public disclosures.¹ The proposed rules, which substitute the term “non-GAAP financial measures” for the “pro forma” financial information addressed by SOA §401(b), include:

- a new Regulation G that would govern the use of “non-GAAP financial measures” in public disclosures;
- new rules that would govern the use of “non-GAAP financial measures” in SEC filings; and
- a new requirement that earnings releases and other public disclosures of annual or quarterly earnings information be filed on Form 8-K within two business days of release.

SOA §401(b) requires the SEC to adopt final rules by January 26, 2003.

B. Regulation G

Proposed Regulation G defines “non-GAAP financial measure” as a numerical measure of a company’s historical or future financial performance, financial position or cash flow that:

- excludes amounts, or is subject to adjustments that have the effect of excluding amounts, that are included in the comparable GAAP measure in the financial statements of the company; or

¹ Securities and Exchange Commission Release Nos. 33-8145; 34-46768; File No. S7-43-02. A copy of the Release is available on the SEC website at <http://www.sec.gov/rules/proposed/33-8145.htm>.

- includes amounts, or is subject to adjustments that have the effect of including amounts, that are excluded from the comparable GAAP measure.

Examples of “non-GAAP financial measures” include a measure of operating income excluding “non-recurring” expense or revenue items and EBITDA, which is not presented in accordance with GAAP. Examples of measures that would not be “non-GAAP financial measures” include sales per square foot or same store sales (provided that the sales measures are in accordance with GAAP).

Regulation G would require a public company that publicly discloses any material information that includes a “non-GAAP financial measure”² also to include with that disclosure:

- the most directly comparable GAAP financial measure; and
- a reconciliation (by schedule or other clearly understandable method), which must be quantitative for historical non-GAAP measures, and quantitative to the extent available without unreasonable efforts for forward-looking information, of the differences between the “non-GAAP financial measure” presented and the most directly comparable GAAP financial measure or measures.

If a company releases the “non-GAAP financial measure” orally, telephonically, in a webcast or broadcast or by similar means, proposed Regulation G would permit the company to post the required accompanying information on the company’s website, provided it discloses the location of this information in its release.

Regulation G also provides that the “non-GAAP financial measure,” taken together with the required accompanying information, may not contain an untrue statement of a material fact or omit to state a material fact necessary to make the presentation of the “non-GAAP financial measure,” in light of the circumstances under which it is presented, not misleading.

C. Use of Non-GAAP Financial Measures in SEC Filings

The SEC proposal also establishes new requirements for the use of “non-GAAP financial measures” in SEC filings.³

² The SEC provides a limited exception from Regulation G for foreign private issuers whose securities are listed outside the United States and who release the information containing “non-GAAP financial measures” only outside the United States.

³ The SEC proposal would implement these changes by amending Item 10 of Regulation S-K and Item 10 of Regulation S-B, and would amend Form 20-F to incorporate the amendments under Regulation S-K.

The SEC proposal provides that whenever a company uses “non-GAAP financial measures” in SEC filings, it must provide:

- a presentation, with equal or greater prominence, of the most directly comparable GAAP financial measure or measures;
- a quantitative reconciliation (by schedule or other clearly understandable method) of the differences between the “non-GAAP financial measure” disclosed and the most directly comparable GAAP financial measure or measures;
- a statement disclosing the purposes for which the company’s management uses the “non-GAAP financial measure” presented; and
- a statement describing the reasons why the company’s management believes the “non-GAAP financial measure” provides useful information to investors.

The requirements for disclosing the purposes and usefulness to investors of the “non-GAAP financial measures” may be satisfied by including the statements in the most recent annual report filed with the SEC (or a more recent filing) and by updating those statements, as necessary, no later than the time of the filing containing the “non-GAAP financial measures”.

The SEC proposal would also prohibit the following in SEC filings:

- presenting a “non-GAAP financial measure” in a manner that would give it greater authority or prominence than the comparable GAAP measure or measures;
- excluding from non-GAAP liquidity measures any charges or liabilities that required, or will require, cash settlement, or would have required cash settlement absent an ability to settle in another manner;
- adjusting a non-GAAP performance measure to eliminate or smooth items identified as non-recurring, infrequent or unusual, when the nature of the charge or gain is such that it is reasonably likely to recur;
- presenting “non-GAAP financial measures” on the face of the company’s GAAP financial statements or in the accompanying notes;
- presenting “non-GAAP financial measures” on the face of any “pro forma” financial information required to be disclosed by Article 11 of Regulation S-X;
- using titles or descriptions of “non-GAAP financial measures” that are the same as, or confusingly similar to, titles or descriptions used for GAAP financial measures; and

- presenting any non-GAAP per-share measure.

D. Earnings Releases to Be Filed on Form 8-K

The SEC proposal would require that all earnings releases and other public disclosures of material non-public information regarding a company's results of operations or financial condition be filed on Form 8-K within two business days of release, whether or not they contain "non-GAAP financial measures." This requirement would thus subject all earnings releases to the new rules relating to the use of "non-GAAP financial measures" in SEC filings.

If such information is disclosed orally, telephonically, by webcast, broadcast or similar means, the company would not be required to file a Form 8-K if:

- the disclosure initially occurs within 48 hours of a written release or announcement filed on Form 8-K;
- the presentation is accessible to the public by dial-in conference call, webcast or similar technology;
- the financial and statistical information contained in the presentation is provided on the company's website, together with any information that would be required under proposed Regulation G; and
- the presentation was announced by a widely disseminated press release that included instructions as to when and how to access the presentation and the location on the company's website where the information would be available.

The foregoing exception would apply if additional non-material information is publicly disclosed following the filing of an earnings release on Form 8-K. However, the SEC proposing release further states that the release of "additional or updated material non-public information" regarding a company's results of operations or financial condition for a completed fiscal year or quarter would trigger an additional Form 8-K filing requirement.

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The SEC requests that comments on the proposed rules be received no later than December 13, 2002. Comments may be submitted electronically to rule-comments@sec.gov. All comment letters should refer to File No. S7-43-02 (in the subject line if sent electronically).

November 21, 2002

For Additional Information

This client alert can be found, together with other recent Chadbourne & Parke LLP client alerts, at http://www.chadbourne.com/publications/sub_Publications.html. If you have any questions regarding this proposal, please contact any of the following:

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