



FENWICK & WEST LLP

CORPORATE & SECURITIES LAW UPDATE

**SEC Issues Final Rule on
Furnishing Earnings
Announcements to the SEC and
on Using Pro Forma Financial
Information Generally**
(Effective March 28, 2003)

February 4, 2003



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On January 15, 2003, the SEC adopted a final rule designed to implement Section 401(b), and to begin to implement Section 409, of the Sarbanes-Oxley Act of 2002. The complete text of this rule can be found at www.sec.gov/rules/final/33-8176.htm.

Beginning March 28, 2003, public companies must:

- furnish a Form 8-K within five business days after issuing any press release or other disclosure about the company's quarterly or annual financial results that contains material nonpublic information; and
- comply with new conditions for the use of financial measures that are not calculated or presented in accordance with GAAP (*i.e.*, pro forma financial information).

I. Furnishing Earnings Releases and Other Financial Announcements on Form 8-K

The SEC's new rule requires public companies to furnish a current report on Form 8-K to report earnings and similar information.

What triggers the new Form 8-K requirement? The Form 8-K is required whenever a public company makes any public announcement, or issues a press release, disclosing material nonpublic financial information regarding its results of operations or financial condition for a *completed quarterly or annual fiscal period*. Releasing additional or updated material nonpublic financial information regarding a completed fiscal year or quarter triggers an additional Form 8-K obligation. Repeating financial information that was previously made public does not trigger the need for a Form 8-K, even if the repeated information is in a different form (e.g., a report to shareholders) or accompanied by new information that is not material.

What is the required content of this Form 8-K? The company must:

- identify the announcement or release briefly in a Form 8-K; and
- include the announcement or release as an exhibit to the Form 8-K.

How quickly does this Form 8-K need to be furnished? The Form 8-K is due within five business days after the announcement or release, but it may be desirable to furnish it immediately for the reasons discussed in the first bullet point below.

How does the new rule apply to analyst conference calls? If no material nonpublic information is disclosed on the conference call, no Form 8-K is required as a result of the call.

If material nonpublic information is disclosed on the conference call, an expanded or further Form 8-K will be required, unless the procedures specified in the next paragraph are followed.

The new rule does not require a Form 8-K in the case of material nonpublic information that is disclosed orally, telephonically or by webcast, broadcast or similar means if:

- the oral information is provided as part of a presentation that is complementary to, and initially occurs within 48 hours after, a related, written announcement or release that has been furnished to the SEC on Form 8-K prior to the presentation;
- the presentation is broadly accessible to the public by dial-in conference call, webcast, broadcast or similar means;
- the financial and other statistical information contained in the presentation is provided on the company's website, together with the Regulation G information discussed below; and
- the presentation is announced in advance by a widely disseminated press release that includes instructions about how to access the presentation and where on the company's website the information is available.

The SEC suggests that companies providing website access do so on the page normally used for investor relations and maintain the information for at least 12 months.

What is the implication of a Form 8-K's being "furnished" rather than "filed?" The Form 8-K and the accompanying press release that are "furnished" to the SEC are not incorporated by reference into registration statements and other filings, and are not subject to liability under Section 18 of the Securities Exchange Act. Other antifraud provisions of the securities laws still apply. A company may specifically choose to "file" the Form 8-K and incorporate that information into its other filings, but additional liability then attaches.

How does this Form 8-K disclosure relate to disclosure required under Regulation FD? These disclosure requirements are separate; both must be met. Regulation FD generally requires that, whenever a public company discloses material nonpublic information regarding the company or its securities to specified persons, it must make simultaneous public disclosure of that information. A company may choose to satisfy this public disclosure requirement by furnishing that information to the SEC pursuant to Item 9 of Form 8-K, but other methods (such as press releases) are available. In contrast, furnishing earnings information on Form 8-K is mandatory. Generally, the annual or quarterly financial information furnished to the

SEC will have been disclosed to the public in a press release and/or webcast that complies with Regulation FD. For a company choosing to use Form 8-K to satisfy its Regulation FD obligation, information that meets both the Item 9 and Item 12 requirements of Form 8-K and indicates it is being furnished under both items would satisfy a company's Regulation FD obligation if it is furnished within the Regulation FD time frame.

II. Conditions for Use of Non-GAAP Financial Measures (Pro Forma Financial Information)

Congress and the SEC believe that pro forma financial information can mislead investors if it obscures financial information presented on a GAAP basis. Section 401(b) of the Sarbanes-Oxley Act directed the SEC to issue rules requiring that any public disclosure or release of pro forma financial information by a public company be (1) presented in a manner that is complete and accurate and (2) reconciled with the financial condition and results of operations of the company as determined by applying GAAP. The SEC has now adopted a new disclosure regulation, known as Regulation G, to implement those requirements.

What is the purpose of the new term “non-GAAP financial measure?” The SEC's existing rules and regulations already use the term “pro forma financial information” in other contexts, and use the term differently than it is used in the Sarbanes-Oxley Act. As a result, the SEC created the term “non-GAAP financial measure” to identify the types of information subject to these new rules.

What constitutes a non-GAAP financial measure? A “non-GAAP financial measure” is a numerical measure of a company's historical or future financial performance, financial position or cash flows that:

- excludes amounts, or is subject to adjustments that have the effect of excluding amounts, that are included in the most directly comparable measure calculated and presented in accordance with GAAP^[1] in the statement of income, balance sheet or statement of cash flows (or equivalent statements) of the company; or
- includes amounts, or is subject to adjustments that have the effect of including amounts, that are excluded from the most directly comparable measure so calculated and presented.

Non-GAAP financial measures specifically would not include operating and other statistical measures (such as unit sales, numbers of employees, numbers of subscribers or numbers of advertisers). The term also would not include ratios or statistical measures calculated using exclusively one or both of:

- financial measures calculated in accordance with GAAP; and
- operating measures or other measures that are not non-GAAP financial measures.

In addition, “non-GAAP financial measure” generally would not include financial measures required to be disclosed by GAAP, SEC rules or other regulatory authorities.

Has the SEC provided examples of how this definition applies? Yes. Examples of ratios and measures that would not be non-GAAP financial measures include sales per square foot (assuming that the sales figure was calculated in accordance with GAAP) and same store sales (again assuming the sales figures for the stores were calculated in accordance with GAAP). An example of a ratio that would not be a non-GAAP financial measure is a measure of operating margin that is calculated by dividing revenues into operating income, where both revenue and operating income are calculated in accordance with GAAP. Conversely, an example of a ratio that would be a non-GAAP financial measure is a measure of operating margin that is calculated by dividing revenues into operating income, where either revenue or operating income, or both, were not calculated in accordance with GAAP.

Non-GAAP financial measures would not include financial information that has no comparable GAAP measure. For example, new Regulation G would not apply to the following measures:

- contracted or anticipated amounts of expected indebtedness;
- amounts of planned repayments;
- estimated revenues or expenses of a new product line, so long as such amounts are estimated in the same manner as would be computed under GAAP; or
- measures of profit or loss and total assets for each business segment required to be disclosed in accordance with GAAP.

What is a company required to do if it wishes to present non-GAAP financial information?

Under new Regulation G, whenever a public company publicly discloses material information that includes a non-GAAP financial measure, the company must accompany that measure with:

- a presentation of the most directly comparable financial measure calculated and presented in accordance with GAAP;
- a quantitative reconciliation (by schedule or other clearly understandable method) of the differences between any historical non-GAAP financial measure disclosed and the most directly comparable GAAP financial measure or measures; and
- to the extent available without unreasonable efforts, a quantitative reconciliation (by schedule or other clearly understandable method) of the differences between any forward-looking non-GAAP financial measure disclosed and the most directly comparable GAAP financial measure or measures.

The SEC has stated that, if the GAAP financial measure is not accessible on a forward-looking basis, a company must disclose that fact and provide reconciling information that is available without unreasonable effort. Furthermore, a company must identify information that is unavailable and disclose its probable significance.

Regulation G also contains an antifraud prohibition – it prohibits a company from making public a non-GAAP financial measure that, taken together with the information accompanying that measure and any other accompanying discussion of that measure, contains an untrue statement of a material fact or omits to state a material fact necessary in order to make the presentation of the non-GAAP financial measure, in light of the circumstances under which it is presented, not misleading.

Regulation G disclosure requirements (and the additional requirements discussed below for SEC-filed documents containing pro forma information) do not apply to pro forma financial information that is included in disclosure relating to a proposed business combination, the entity resulting therefrom or an entity that is a party thereto, if the disclosure is contained in a communication that is subject to the SEC communication rules applicable to business combination transactions (Rule 425). Also, the SEC has given additional latitude in certain circumstances to foreign private issuers with regard to disclosure of non-GAAP financial measures.

In what context will these presentation and reconciliation requirements typically be brought into play? The most likely triggers for the Regulation G disclosure requirements are pro forma financial information in companies' quarterly and year-end financial press releases and their quarterly analyst calls. Forms 10-K, 10-Q and 8-K and registration statements filed with the SEC and containing pro forma financial information would also be subject to Regulation G. Press releases, analyst calls and filed documents containing only GAAP presentations would not trigger these requirements.

Do the same presentation and reconciliation requirements apply to oral statements containing non-GAAP financial measures? No, but Regulation G requires that these oral statements be posted. Specifically, the rule says that, where a non-GAAP financial measure is made public orally, telephonically or by webcast, broadcast or similar means, the company can satisfy its Regulation G disclosure requirements by:

- providing the required presentation and reconciliation disclosures on the company's website at the time the non-GAAP financial measure is made public; and
- publicly announcing the location of the website in the same presentation in which the non-GAAP financial measure is made public.

The SEC suggests that companies provide website access to the posted information for at least 12 months.

NOTE – oral disclosure of material pro forma financial information not included in the press release may trigger the need to furnish a second Form 8-K if the Form 8-K that included the press release was not furnished to the SEC prior to the public oral disclosure. Alternatively, a company may be able to consolidate information from the press release and from the conference call in a single Form 8-K that is filed within five business days after the press release. See Part I of this memorandum.

Are there different requirements when a non-GAAP financial measure is included in a filing with the SEC? Yes. Whenever an SEC filing includes a non-GAAP financial measure, additional requirements, on top of the Regulation G requirements discussed above, apply. These additional requirements also apply to a “furnished” Form 8-K providing a company’s earnings release. Such an SEC filing or Form 8-K must:

- present the most directly comparable GAAP financial measure with equal or greater prominence than the non-GAAP financial measure;
- disclose the reasons why the company’s management believes that the non-GAAP financial measure provides useful information to investors regarding its financial condition and results of operations; and
- to the extent material, disclose any additional purposes for which the company’s management uses the non-GAAP financial measure.

The SEC has indicated that a company’s presented justifications must be specific to the non-GAAP financial measure used, the company, the nature of the company’s business and industry, and the manner in which management assesses the non-GAAP financial measure and applies it to management decisions. A company should discuss why investors would find the measure valuable in the context in which it is provided, given either the excluded items or the additional items included. The sole supporting reason cannot be utility of a measure to securities analysts.

For earnings releases, companies may satisfy the second and third bullet point requirements immediately above by including the required disclosure in the Form 8-K or in the release or announcement that is included as an exhibit to the Form 8-K. The requirement of “equal or greater prominence,” however, would demand that the press release itself be drafted in a compliant manner since a lack of compliance in the press release could not be rectified by additional disclosure in the Form 8-K. More generally, the statement disclosing the reasons why the company believes that presentation of the non-GAAP financial measure provides useful information to investors and the statement disclosing the additional

purposes for which the company uses the non-GAAP financial measure need not be included in each SEC filing (other than a Form 10-K) that includes a non-GAAP financial measure if they were included in the company's most recent Form 10-K or a more recent filing and the required information is updated to the extent necessary at the time of the current filing.

Are there any specific prohibitions on non-GAAP financial measures used in SEC filings? Yes. The new rule prohibits several practices in SEC filings (but not in press releases furnished to the SEC under cover of a Form 8-K). Specifically, in an SEC filing, a company may not do any of the following:

- exclude charges or liabilities from non-GAAP liquidity measures, other than EBIT and EBITDA, if those charges or liabilities required (or will require) cash settlement, or would have required cash settlement absent an ability to settle in another manner;
- adjust a non-GAAP financial measure to eliminate or smooth items identified as non-recurring, infrequent or unusual, when there was a similar charge or gain within the prior two years or a similar charge or gain is reasonably likely to recur within two years;
- present any non-GAAP financial measure on the face of the company's financial statements prepared in accordance with GAAP, or in the accompanying notes;
- present any non-GAAP financial measure on the face of any pro forma financial information required to be disclosed in the context of a business combination; or
- use 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.

What if I have more questions?

Should you have any questions about these new requirements, please feel free to contact any member of your Fenwick & West team. You may also contact Laird Simons (lsimons@fenwick.com), Dan Winnike (dwinnike@fenwick.com) or Horace Nash (hnash@fenwick.com) who contributed to this update.