



FENWICK & WEST LLP

CORPORATE & SECURITIES LAW UPDATE

SEC Brings First Enforcement Action Related to Pro Forma Financial Disclosures; Best Practices for Pro Forma Disclosures

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SEC Brings First Enforcement Action Related to Pro Forma Financial Disclosures; Best Practices for Pro Forma Disclosures

The SEC has announced its first enforcement action against an issuer for providing misleading pro forma earnings information. The action, against Trump Hotels & Casino Resorts Inc., concluded that Trump Hotels violated the antifraud provision of the securities laws by recklessly issuing a materially misleading press release. The SEC has ordered Trump Hotels to cease and desist from violating the Securities Exchange Act and Rule 10b-5 and Trump Hotels has consented to the issuance of the order without admitting or denying the SEC's findings.

This enforcement action is a reminder to all companies that the SEC is focused on the use of pro forma financial disclosures, and all companies must be careful when including pro forma financial disclosures in their earnings releases.

Facts Regarding Trump Hotels' Misleading Press Release

The SEC claimed that a 1999 Trump Hotels' earnings release was materially misleading because it created the false and misleading impression that Trump Hotels had exceeded earnings expectations primarily through operational improvements. Trump Hotels' earnings release expressly stated that the net income figure excluded a one-time charge, implying that no other significant one-time items were included in the net income figures disclosed in the earnings release. Contrary to that implication, however, the net income figures included a significant one-time gain, which was not separately disclosed or explained in the earnings release. If Trump Hotels had not included this one-time gain in its net income figures, Trump Hotels' revenues and net income would have decreased from the prior year and Trump Hotels would have failed to meet analysts' expectations. The undisclosed one-time gain represented the difference between positive trends in revenues and earnings and negative trends in revenues and earnings, and the difference between exceeding analysts' expectations and falling short of them. Thus, the omission of information about the one-time gain obscured a negative trend and a failure to meet analysts' expectations, and therefore could reasonably have led analysts and investors to draw false conclusions about Trump Hotels' quarterly results. On this earnings announcement, the price of Trump Hotels stock rose; on revelation of the effect of the one-time gain, the price fell.

Best Practices for Pro Forma Disclosures

The Trump Hotels' enforcement action is a clear reminder to companies that they must be careful when disclosing pro forma earnings information. As a result, we remind you to review the guidelines for earnings press releases developed by Financial Executives International and the National Investors Relations Institute, as well as the recommendations

recently made by the SEC regarding pro forma earnings disclosures. We provided copies of these recommendations to you in an earlier communication about developments in pro forma earnings disclosures.

The FEI/NIRI recommendations can be found at:

<http://www.fei.org/news/FEI-NIRI-EPRGuidelines-4-26-2001.cfm>. The recent SEC alert

regarding pro forma disclosures can be found at:

<http://www.sec.gov/rules/other/33-8039.htm>. NIRI also recently released a survey of the

use of pro forma reporting, the results of which can be found at:

<http://www.niri.org/publications/alerts/EA20020117.cfm>.

Best practices when using pro forma disclosures include the following:

- Include GAAP numbers in your earnings release.
- Provide pro forma information only to the extent that you believe it provides meaningful information to investors. For example, pro forma presentation may be appropriate if you believe the information is necessary to focus investors' attention on the Company's core operations or to provide more meaningful comparisons of financial results from one period to another.
- As illustrated by the Trump Hotels enforcement action, in preparing pro forma information, treat similar items in a given reporting period in the same fashion. For example, if you exclude a one-time loss or expense, evaluate whether there are other one-time charges or gains that should similarly be excluded.
- If you provide pro forma information, make sure that you clearly identify it as "pro forma" rather than GAAP.
- If you provide pro forma information, describe in plain English within the earnings release the basis on which the pro forma information was prepared, including reference to particular types of transactions that have been excluded or adjustments that have been made.
- Provide a clear reconciliation to GAAP results of any pro forma information presented (consider using a table). If this reconciliation is not a part of a presentation of pro forma financial statements, consider referencing the location of the reconciliation at the beginning of any presentation of pro forma financial statements.
- Reconcile GAAP and pro forma results in a similar fashion for comparable periods. If you must change the basis for your pro forma presentation in a later period, make sure to explain the changes, explain the reasons for the changes and adjust prior period pro forma results to provide comparability.

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- Carefully consider whether it is appropriate to include pro forma disclosures in the headlines of the press release, rather than just in the text. If you include pro forma disclosures in the headlines, make sure they are adequately explained.
 - Consider including a warning of some sort about investor reliance on the pro forma disclosures. For example, before a presentation of pro forma financial statements, consider a warning such as the following:

"The following pro forma supplemental financial information is presented for informational purposes only, as an aid to understanding the company's operating results. This pro forma information is not prepared in accordance with generally accepted accounting principles and should not be considered a substitute for the historical financial information presented in accordance with GAAP. The pro forma measures used by the company may be different from pro forma measures used by other companies."

- As illustrated by the Trump Hotels enforcement action, be careful about providing pro forma results that obscure trends in the GAAP results. In these situations, you may need to provide more explanation about the GAAP results or the effects of the pro forma exclusions, especially where a GAAP loss becomes a pro forma profit. You should also be careful about how you balance the GAAP and pro forma disclosures, especially if you include pro forma results in the press release headlines.

Should you have any questions or concerns regarding your use of pro forma financial disclosures, please do not hesitate to contact us.