



**FENWICK & WEST LLP**

*CORPORATE & SECURITIES LAW UPDATE*

# SEC Issues Rule Proposal on Filing of Earnings Announcements and Use of Pro Forma Financial Information

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## **SEC Issues Rule Proposal on Filing of Earnings Announcements and Use of Pro Forma Financial Information**

On November 5, 2002, the SEC issued a rule proposal 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/proposed/33-8145.htm](http://www.sec.gov/rules/proposed/33-8145.htm).

Although this is currently only a proposal, we expect the SEC to adopt a final rule soon after the proposal's 30-day comment period ends, and we expect the substance of the final rule to be similar to what has been proposed.

The rule proposal would require public companies:

- to file a Form 8-K within two business days for any press release or other disclosure about the company's quarterly or annual financial results that contains material non-public information; and
- to 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. Filing Earnings Releases and Other Financial Announcements on Form 8-K**

Section 409 of the Sarbanes-Oxley Act obligates public companies to disclose on a rapid and current basis such information concerning material changes in their financial condition or results of operations as the SEC requires by rule. The SEC's proposed rule would require public companies to file a current report on Form 8-K to report earnings announcements and similar information.

#### **What would trigger a Form 8-K filing?**

A public company that makes any public announcement or release disclosing material non-public financial information for a completed quarterly or annual fiscal period would be required:

- to identify the announcement or release briefly in a Form 8-K; and
- to file the text of that announcement or release as an exhibit to the Form 8-K.

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**How quickly would this Form 8-K need to be filed?**

The Form 8-K filing would be due within two business days after the announcement or release.

**Are there any proposed exceptions to this Form 8-K filing requirement?**

Yes. Repeating financial information previously made public would not trigger the need for an additional Form 8-K filing. This would be true even if the repeated information were in a different form or accompanied by new information that was not material. Also, the proposed rule would not require a filing in the case of material non-public information that is disclosed orally, telephonically, or by webcast or similar means if:

- the information is provided as part of a presentation less than 48 hours after a related written announcement that is filed on Form 8-K;
- the public can access the presentation by telephone, webcast or similar technology;
- financial and 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 accessing the presentation and where the information is available.

**Must forward-looking financial information be filed the same way?**

Forward-looking information, if specifically identified, can be "furnished" but not "filed" in the Form 8-K along with the financial announcement. Forward-looking information would not be subject to liability under Section 18 of the Exchange Act and would not be incorporated by reference into a registration statement, proxy statement or other report.

**How does this Form 8-K disclosure relate to disclosure required under Regulation FD?**

The proposed Form 8-K requirement would be in addition to the requirements of Regulation FD. Regulation FD generally requires that, whenever a public company discloses any material nonpublic information regarding the company or its securities to specified persons, it must make simultaneous public disclosure of that information. Unlike Form 8-K disclosure made to satisfy Regulation FD, however, historical information filed under the proposed new Form 8-K requirement always would be considered "filed" with the SEC for liability purposes. Information "furnished" to the SEC under existing Item 9 of Form 8-K for Regulation FD purposes would not satisfy the SEC's proposed filing requirements, since it is not considered "filed" with the SEC. Information that is formally "filed" pursuant to the proposed Form 8-K requirements would satisfy a company's Regulation FD obligation if it is filed within the Regulation FD time frame.

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### **How does the proposed rule affect traditional earnings announcement practices?**

Public companies typically issue a press release to announce their quarterly earnings and follow that release with a same-day or next-day conference call that is open to the public. Many do not file Forms 8-K for purposes of filing the press release (or its basic contents) with the SEC. If the proposed rule is adopted, companies would be required to file Forms 8-K within two business days, attaching the release. Further, companies would be required to post on their website any related material, nonpublic financial or statistical information presented in the conference call but not in the earnings release, together with any required Regulation G information, as discussed below. Companies will also need to ensure that any pro forma information included in the press release complies with the requirements of proposed Regulation G and other rules that may be applicable, as discussed below.

## **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 and manipulate 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 presented in a manner that is complete and accurate and is reconciled with the financial condition and results of operations of the company as determined by applying GAAP.

### **How has the SEC defined what constitutes pro forma financial information?**

The SEC's existing rules and regulations already use the term "pro forma financial information" in other contexts and use that term differently than it is used in the Sarbanes-Oxley Act. As a result, the SEC has proposed a new term, "non-GAAP financial measure," to identify the types of information targeted by Section 401(b) of the Sarbanes-Oxley Act. "Non-GAAP financial measure" is defined to be 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 comparable measure calculated and presented in accordance with GAAP in the statement of income, balance sheet or cash flows (or equivalent statements) of the company (for example, EBITDA); or
- *includes* amounts, or is subject to adjustments that have the effect of including amounts, that are excluded from the comparable measure so calculated and presented.

Non-GAAP financial measures specifically would not include operating and other financial measures (such as unit sales, numbers of employees, numbers of subscribers or numbers of

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advertisers). The term would also not include any ratios or measures (such as sales per square foot or store sales) calculated using only:

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

The SEC proposes to give additional latitude with regard to disclosure of non-GAAP financial measures in certain circumstances to foreign private issuers.

**What would a company be required to do if it wishes to present pro forma information?**

Under a proposed new Regulation G, whenever a public company publicly discloses or releases material information that includes a non-GAAP financial measure, it must be accompanied by:

- 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) between any quantitative *historical* non-GAAP financial measure and the most directly comparable GAAP financial measure; and
- *to the extent available without unreasonable efforts*, a quantitative reconciliation (by schedule or other clearly understandable method) between any *forward-looking* non-GAAP financial measure and the most directly comparable GAAP financial measure, or for information that is not available, the reasons why not and the probable significance of the information.

Regulation G would also prohibit 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.

**In what context will these requirements typically be brought into play?**

Generally, the most likely triggers for these disclosure requirements will be companies' quarterly and year-end financial press releases, their quarterly analyst calls and their filing of documents such as Forms 10-K, 10-Q and 8-K and registration statements with the SEC. Pro forma financial information required under Regulation S-X in connection with a corporate acquisition would not trigger these requirements. Press releases, analyst calls and filed documents containing only GAAP presentations would not trigger these requirements.

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**Do the same requirements apply to oral statements?**

No. 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 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.

**Are there different requirements when a non-GAAP financial measure is included in a filing with the SEC?**

Yes. Where a non-GAAP financial measure is disclosed in an SEC filing, the following requirements, *in addition to those discussed above*, would apply. Such an SEC filing must:

- include a quantitative reconciliation for forward-looking disclosure, regardless of whether it is available without unreasonable efforts;
- disclose the purposes for which the company's management uses the non-GAAP financial measure; and
- disclose the reasons why the company's management believes that presentation of the non-GAAP financial measure provides useful information to investors regarding its financial condition and results of operations.

As to why investors may find the non-GAAP financial measure useful, the utility of a measure to securities analysts cannot be the sole support for presenting the non-GAAP financial measure. Rather, the justification for the use of the measure must be substantive.

The statement disclosing the purposes for which the company uses the non-GAAP financial measure and the statement disclosing the reasons why the company believes that presentation of the non-GAAP financial measure provides useful information to investors need not be included in each 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 another more recent filing and the required information is updated to the extent necessary as of the current filing.

**Are there any prohibitions on using non-GAAP financial measures in documents filed with the SEC?**

Yes. The proposed rule would prohibit each of the following in an SEC filing:

- presentation of a non-GAAP financial measure in a manner that would give it

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greater authority or prominence than the comparable GAAP financial measure or measures;

- exclusion of charges or liabilities that required, or will require, cash settlement, or would have required cash settlement absent an ability to settle in another manner, from non-GAAP liquidity measures;
- adjustment of a non-GAAP financial 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;
- presentation of non-GAAP financial measures on the face of the company's financial statements prepared in accordance with GAAP or in the accompanying notes;
- presentation of non-GAAP financial measures on the face of any pro forma financial information required to be disclosed in the context of a business combination;
- use of 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; or
- presentation of any non-GAAP financial measure on a per share basis.

As discussed above, the SEC is proposing to require companies to include their earnings announcements with Form 8-K filings that will be made with the SEC. As a result, it is not clear whether the requirements and prohibitions related to pro forma disclosures in SEC filings will apply to earnings announcements that include pro forma disclosures.

## **What if I have more questions?**

Should you have any questions about these proposed new requirements, please feel free to contact any member of your Fenwick & West team. You may also contact Laird Simons ([lsimons@fenwick.com](mailto:lsimons@fenwick.com)), Horace Nash ([hnash@fenwick.com](mailto:hnash@fenwick.com)), Eileen Duffy Robinett ([erobinett@fenwick.com](mailto:erobinett@fenwick.com)) or Dan Winnike ([dwinnike@fenwick.com](mailto:dwinnike@fenwick.com)), each of whom contributed to the preparation of this update.