

# Capital Markets and Securities

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A bulletin prepared by the Capital Markets Group at Vedder Price designed to keep corporate executives and investment banking professionals informed of major developments in the securities industry.

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## SEC ADOPTS RULES ON PRO FORMA FINANCIAL INFORMATION AND FILING OF EARNINGS RELEASES

The SEC has adopted new rules governing the use of pro forma financial information by public companies in earnings announcements and SEC filings. The SEC will also require public companies to “furnish” their published annual and quarterly earnings announcements to the SEC on Form 8-K within five business days of publication. The new rules and amendments implement the requirements of Sections 401(b) and 409 of the Sarbanes-Oxley Act.

### *Non-GAAP Financial Information in Earnings Announcements and Other Public Disclosures*

Newly adopted Regulation G under the Securities Exchange Act of 1934 applies to the public disclosure or release of material information by a public company (other than a registered investment company) that includes a “non-GAAP financial measure.”<sup>1</sup>

*Definition of “Non-GAAP Financial Measure”.* A “non-GAAP financial measure” is generally defined as a numerical measure of a company’s financial performance that:

- excludes amounts that are included in the most directly comparable GAAP financial measure, i.e., a financial measure calculated and presented in accordance with GAAP in the statement of income, balance sheet or statement of cash flows (or equivalent statements) of the issuer; or
- includes amounts that are excluded from the most directly comparable GAAP financial measure.

Examples of non-GAAP financial measures include presentation of EBITDA and operating or net income exclusive of “non-recurring” expenses. Non-GAAP financial measures do not include operating and statistical measures (such as unit sales, number of subscribers and similar information), or ratios or measures that are derived using only (i) GAAP financial measures and (ii) operating or other measures that are not non-GAAP financial measures.

*Conditions to Use of Non-GAAP Financial Measures.* When a public company publicly discloses or releases any material information that includes a non-GAAP financial measure, Regulation G requires:

- a presentation of the most directly comparable GAAP financial measure; and
- a quantitative reconciliation of the differences between the non-GAAP financial measure and the most directly comparable GAAP financial measure.

Regulation G prohibits publication of any non-GAAP financial measure that, taken together with accompanying information, is false or misleading.

The Regulation G requirements apply to both historical and forward-looking non-GAAP financial measures. In the case of forward looking non-GAAP financial measures, if the corresponding GAAP financial measure is not accessible on a forward-looking basis, companies will be required to explain why not and provide reconciling information if available without unreasonable effort.

### **Non-GAAP Financial Information in SEC Filings**

The SEC also adopted rules which address the use of non-GAAP financial measures in SEC filings. These new rules appear in Item 10 of Regulation S-K and Item 10 of Regulation S-B. The new rules generally apply the same conditions to the presentation of non-GAAP financial measures as Regulation G and, in addition, require an explanation as to why management uses the non-GAAP financial measure and why it is useful information to investors.

Item 10, as amended, will also prohibit each of the following types of disclosures in Exchange Act filings:

- presenting a non-GAAP financial measure in a manner that would give it greater authority or prominence than the comparable GAAP financial measure;
- excluding 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 (although companies may present EBITDA subject to the other requirements of Item 10);
- 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 within two years or there was a similar charge or gain within the prior two years;
- presenting non-GAAP financial measures on the face of financial statements prepared in accordance with GAAP 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; and
- 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.

### **Furnishing Earnings Announcements on Form 8-K**

The SEC also adopted provisions requiring that public companies “furnish” to the SEC releases or announcements disclosing material non-public financial information about completed annual or quarterly fiscal periods.<sup>2</sup> These provisions are reflected in new Item 12 to Form 8-K. Earnings releases or announcements are not required by these amendments, but if made, they trigger a Form 8-K requirement within five business days of publication. The new Form 8-K requirement applies regardless of whether the release or announcement included disclosure of a non-GAAP financial measure. Earnings releases and announcements furnished pursuant to Item 12 of Form 8-K will not be required to comply with the prohibitions of Item 10 of Regulation S-K described above. However, if the announcement or release includes a non-GAAP financial measure, companies must indicate in the furnished Form 8-K an explanation as to why management uses the non-GAAP financial measure and why it is useful to investors.

Public disclosure of financial information for a completed fiscal period in a presentation that is made orally, telephonically, by Web cast, by broadcast, or by similar means will not be required to be furnished on Form 8-K if:

- the presentation occurs within 48 hours of a related release or announcement that is furnished on Form 8-K;
- the presentation is broadly accessible to the public; and
- the information in the Web cast is posted on the company’s Web site.

### **Application to Foreign Private Issuers**

Regulation G will provide a limited exception for foreign private issuers where (1) the securities of the issuer are listed or quoted on a securities exchange or inter-dealer quotation system outside the United States; (2) the non-GAAP financial measure and the most comparable GAAP financial measure are not calculated and presented in accordance with U.S. GAAP; and (3) the disclosure is made by or on behalf of the issuer outside the United States, or is included in a written communication that is released by or on behalf of the issuer outside the United States. The SEC also adopted amendments to apply the requirements of amended Item 10 of Regulation S-K and Item 10 of Regulation S-B to annual reports filed with the SEC by foreign private issuers.

### **Timing of Effectiveness**

The new rules and amendments will be effective on March 28, 2003 and will apply to all public companies, including small business issuers, who file reports under Section 13(a) or 15(d) of the Exchange Act.

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1 To avoid confusion with the term “pro forma financial information” as used in Regulation S-X, the SEC uses the term “non-GAAP financial measure” to identify the type of information targeted by the Sarbanes-Oxley Act.

2 Because such earnings releases or announcements may be “furnished” as opposed to filed, companies electing to “furnish” releases or announcements will not be subject to liability under Section 18 of the Exchange Act in respect of such releases or announcements, and such releases and announcements will not be automatically incorporated into a public company’s registration statements on Forms S-2, S-3, S-8 or other SEC filings.

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## VEDDER, PRICE, KAUFMAN & KAMMHOLZ

### About Vedder Price

Vedder, Price, Kaufman & Kammholz is a national, full-service law firm with more than 200 attorneys in Chicago, New York City and Livingston, New Jersey. The attorneys in the firm's Capital Markets Group regularly represent corporations and investment bankers, both foreign and domestic, in a wide variety of matters, including:

- debt and equity offerings, including initial public offerings, structured debt financings, aircraft securitizations, dual-class equity structures, and sophisticated preferred stock instruments;
- capital formation for initial capitalization, financing ongoing operations, and acquisitions;
- corporate disclosure, periodic reporting, proxy solicitations, and insider trading and beneficial ownership compliance matters;
- private placement of securities, including Rule 144A and Regulation S transactions;
- tender offers, mergers and acquisitions, and recapitalizations and restructurings;
- international offerings of securities and compliance by foreign issuers with U.S. securities laws;
- litigation and administrative and arbitration proceedings involving various securities fraud claims, disclosure issues, and regulatory enforcement matters; and
- municipal bond financings.

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