



Securities Alert

November 14, 2002

Use of Non-GAAP Financial Measures

The SEC recently proposed rules to implement Section 401(b) of the Sarbanes-Oxley Act of 2002 regarding public disclosure of “pro forma financial information,” which the proposal terms “non-GAAP financial measures”. The proposal applies one set of rules for all public disclosures of non-GAAP financial measures and another, more stringent set, when these disclosures are included in SEC filings. The proposals do not apply to registered investment companies. In addition, the SEC proposed rules pursuant to Section 13(l) of the Exchange Act, added by Section 409 of Sarbanes-Oxley, requiring that public companies file on Form 8-K any earnings release or announcement disclosing material non-public financial information about a completed fiscal year or quarter. A summary of the proposals follows:

PROPOSED DEFINITION OF “NON-GAAP FINANCIAL MEASURE”

The proposal defines “non-GAAP financial measure” as a numerical measure of a Company’s historical or future financial performance 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 statement of cash flows; or
- includes amounts, or is subject to adjustments that have the effect of including amounts, that are excluded from the comparable GAAP measure so calculated and presented.

Examples of non-GAAP financial measures include:

- EBITDA; and
- measures of operating income that exclude expense or revenue items that are identified as “non-recurring”.

Non-GAAP financial measures would not include such things as:

- operating and other statistical measures (such as unit sales, number of employees, number of subscribers or number of advertisers); and
- ratios or measures that are calculated using only financial measures calculated in accordance with GAAP or operating measures or other statistical measures that are not non-GAAP financial measures.

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DISCLOSURE OF “NON-GAAP FINANCIAL MEASURES”

The SEC proposes to adopt a new Regulation G that would require that, whenever a company publicly discloses or releases material information that includes a “non-GAAP financial measure,” the company must accompany it with:

- a presentation of the most comparable financial measure calculated and presented in accordance with GAAP; and
- a reconciliation (by schedule or other clearly understandable method) which shall be quantitative for historical measures and, to the extent available without unreasonable efforts, for forward-looking measures, of the differences between the non-GAAP financial measure presented and the comparable financial measure or measures calculated and presented in accordance with GAAP. The company must identify any forward-looking information that is unavailable and disclose its probable significance.

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

If a non-GAAP financial measure is released orally, telephonically or in a webcast, the proposed regulation would permit an issuer to provide the required comparative information by posting it on its website, provided that the location of the website and the availability of the comparative information is made public during the same presentation as the non-GAAP financial measure.

Limited Exception for Foreign Private Issuers

Regulation G would apply to foreign private issuers, except for those to which all of the following conditions apply:

- its securities are listed or quoted on a securities exchange or inter-dealer quotation system outside the United States;
- the non-GAAP financial measure and the most comparable GAAP financial measure are not calculated and presented in accordance with generally accepted accounting principles in the United States; and
- 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 only outside the United States.

USE OF NON-GAAP FINANCIAL MEASURES IN SEC FILINGS

The proposed amendments¹ applicable to non-GAAP financial measures in SEC filings require more disclosure than Regulation G. They require:

¹ The proposals amend Item 10 of Regulation S-K, Item 10 of Regulation S-B and Form 20-F.

- a **presentation**, with equal or greater prominence, 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 the non-GAAP financial measure disclosed with the most directly comparable measure calculated and presented in accordance with GAAP;
- a **statement** disclosing why management uses the non-GAAP financial measure presented; and
- a statement **describing** why management believes such non-GAAP financial measures provide useful information to investors.

In addition, the proposed amendments would prohibit the following:

- 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;
- 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 GAAP financial statements or their footnotes, or on the face of required pro forma financial information or using titles or descriptions for the non-GAAP financial measures that are confusingly similar to those for GAAP financial measures; and
- presenting a non-GAAP per-share measure.

The proposed amendments would apply to disclosures of non-GAAP financial measures that represent projections or forecasts of results of business combination transactions.

No Exemption for Foreign Private Issuers

The proposed amendments do not provide an exception for foreign private issuers, except to the extent that the non-GAAP financial information is in accordance with the foreign GAAP used in the issuer's primary financial statements.

AMENDMENT TO FORM 8-K REQUIRING FILING CERTAIN RELEASES AND ANNOUNCEMENTS

The SEC's proposal would require public companies to file, within two days of any release or public announcement of material non-public financial information about a completed fiscal year or quarter, a Form 8-K containing such release or announcement. This part of the proposal is not related to non-GAAP financial measures because the proposed filing requirement would apply whether or not the release or announcement included disclosure of non-GAAP financial measures.

The proposal does not require filing of public disclosure of financial information for a completed fiscal period in a presentation that is made orally, telephonically, by webcast or broadcast if:

- the presentation occurs within 48 hours of a related release or announcement that is filed on Form 8-K;
- the presentation is accessible to the public;
- the financial information contained in the presentation for a completed fiscal period is posted on the company's website; and
- the presentation was announced by a widely disseminated press release that included instructions on how to access the presentation and the location of the company's website where the information would be available.

These proposed requirements are in addition to the requirements of Regulation FD. Information furnished under existing Item 9 of Form 8-K for the purpose of Regulation FD would not satisfy the proposed requirement. Information filed pursuant to the proposed requirement would satisfy Regulation FD if filed in accordance with the time frame established by Regulation FD. The requirements do not apply to announcements and disclosures made only in filed 10-Qs.

COMMENT PROCESS AND EFFECTIVE DATE

The proposed rules are subject to comment for 30 days following their publication in the *Federal Register* before the SEC may issue final rules. Under the terms of Sarbanes-Oxley, the final rules regarding non-GAAP financial measures must be issued by January 26, 2003. A final date for the rules regarding the amendment to Form 8-K requiring filing certain releases and announcements was not specified and such rules may go into effect as determined by the SEC.

CONTACT INFORMATION

If you have any questions or would like to learn more about the proposed rules, please contact the lawyer who normally represents you, or any of the lawyers listed below involved in the preparation of this SEC Alert.

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