



SEC Adopts Final Rules Regarding Earnings Releases on Form 8-K, Disclosure of Non-GAAP Financial Measures, and MD&A Disclosure of Off-Balance Sheet Arrangements and Contractual Obligations



THE SEC HAS ADOPTED FINAL RULES REGARDING furnishing earnings releases on Form 8-K, disclosure of financial information that includes a non-GAAP financial measure, and disclosure of off-balance sheet arrangements and contractual obligations. This Client Alert addresses each of these new rules, as well as their impact on foreign private issuers.

Furnishing Earnings Releases on Form 8-K

The SEC issued final rules that amend Form 8-K to add a new Item 12, "Disclosure of Results of Operations and Financial Condition." Effective March 28, 2003, Item 12 requires companies to furnish to the SEC a Form 8-K within five business days of a public announcement or release of any material non-public information regarding a company's results of operations or financial condition for an annual or quarterly fiscal period that has ended. Item 12 requires the company to identify the announcement or release on Form 8-K and then include the announcement or release as an exhibit to the Form 8-K.

The requirement to furnish a Form 8-K under Item 12 applies regardless of whether the release or announcement includes disclosure of a non-GAAP financial measure. Item 12 is not triggered by repetition of information that was previously publicly disclosed, unless the repeated information is accompanied by additional or updated material non-public information regarding the company's results of operations or financial condition for a completed fiscal year or quarter. Item 12 also does not apply to public disclosure of earnings estimates for future or ongoing fiscal periods, unless those estimates are included in the public announcement or release of material non-public information regarding a completed annual or quarterly fiscal period. Moreover, Item 12 does not apply to companies that make announcements and disclosures regarding results of operations or financial condition for a completed fiscal year or quarter only in their periodic reports filed with the SEC on Form 10-K or Form 10-Q.

Applicability to Analyst Calls, etc. Where non-public information is disclosed orally, telephonically, by webcast, by broadcast, or by similar means in a presentation that is *complementary to, and occurs within 48 hours after,* a related, public written release or announcement, a company is not required to furnish an additional Form 8-K with regard to such information if:

- The related written release or announcement has been furnished to the SEC on Form 8-K pursuant to Item 12 *prior to the presentation*;
- The presentation is broadly accessible to the public by conference call, webcast or similar technology;
- The financial and statistical information contained in the presentation is provided on the company's web site, together with any information regarding non-GAAP financial measures that would be required under Regulation G (discussed below); and
- The presentation was announced by a widely disseminated press release that included instructions as to when and how to access the presentation and the location on the company's web site where the information would be available.

The key point to note about this exception is that the Form 8-K containing the written announcement must be furnished to the SEC before the conference call. This means that the historically common practice of issuing an earnings release Tuesday evening at 6:00 p.m., followed by an analyst call Wednesday morning at 8:00 a.m., will have to be modified.

Filing versus Furnishing The final rule differs from the proposed rule in that it requires companies to "furnish" rather than "file" earnings releases on Form 8-K. This is a significant change for companies, because information that is furnished to the SEC is not incorporated by reference into a company's Securities Act registration statements, and is therefore not subject to the stricter liability standards under Sections 11 and 12 of the Securities Act. In addition, furnished information is not subject to the liability provisions of Section 18 of the Exchange Act.

Although furnished information is not subject to the requirements of Item 10 of Regulation S-K and Regulation S-B regarding the use of non-GAAP financial measures in documents filed with the SEC (discussed below), companies are required to disclose:

- The reasons why management believes that presentation of the non-GAAP financial measure provides useful information to investors regarding the company's financial condition and results of operations; and
- To the extent material, the additional purposes, if any, for which management uses the non-GAAP financial measure that are not otherwise disclosed.

A company may satisfy these requirements by including the disclosure in the Form 8-K or in the release or announcement that is included as an exhibit to the Form 8-K. Companies may also satisfy these requirements by including the disclosure in their most recent annual report filed with the SEC (or a more recent filing) and by updating those statements, as necessary, no later than the time the Form 8-K is furnished to the SEC.

D Disclosing Non-GAAP Financial Measures; Regulation G

The SEC has often reiterated its concerns that, under certain circumstances, non-GAAP financial measures obscure a company's GAAP results and could mislead investors. To address this issue, the SEC has adopted final rules that create new Regulation G. This regulation generally prohibits a company, or a person acting on its behalf, from making public a non-GAAP financial measure that contains an untrue statement of a material fact or omits a material fact necessary to make the presentation of the non-GAAP financial measure not misleading.

Additionally, whenever a company discloses any material information that includes a non-GAAP financial measure, Regulation G requires the company to provide the following information:

- A presentation of the most directly comparable financial measure calculated and presented in accordance with GAAP; and
- A quantitative reconciliation of the differences between the non-GAAP financial measure and the most directly comparable GAAP financial measure. (For prospective measures, the reconciliation must only be quantitative to the extent available without unreasonable efforts; if not available the company must **(i)** disclose that fact and provide reconciling information that is available without an unreasonable effort and **(ii)** identify information that is unavailable and disclose its probable significance.)

If a company releases a non-GAAP financial measure orally, telephonically, by webcast, by broadcast or by similar means, it may provide the accompanying information required by Regulation G by either posting the information on the company's web site or disclosing the location and availability of the required accompanying information during its presentation.

Definition of Non-GAAP Financial Measures

Regulation G defines a non-GAAP financial measure as a numerical measure

of a company's financial performance, financial position or cash flows that:

- Excludes amounts, or is subject to adjustments that have the same effect, that are included in the most directly comparable GAAP measure presented in the income statement, balance sheet or statement of cash flows (or equivalent statements) of the company; or
- Includes amounts, or is subject to adjustments that have the same effect, that are excluded from the most directly comparable GAAP measure presented.

This definition of non-GAAP financial measures encompasses performance measures that are different from those in the financial statements, and liquidity measures that are different from cash flow computed in accordance with GAAP. Examples of non-GAAP financial measures include:

- A measure of operating income that excludes one or more expense or revenue items that are identified as "non-recurring"; and
- EBITDA.

Examples of information *not* considered to be "non-GAAP financial measures" and therefore *not* subject to Regulation G include:

- Operating and other statistical measures;
- Ratios calculated using exclusively one or both of: GAAP financial measures; and operating measures that are not non-GAAP financial measures;
- Disclosure of amounts of expected indebtedness, including contracted and anticipated amounts;
- Disclosure of amounts of repayments that have been planned or decided upon but not yet made;
- Disclosure of estimated revenues or expenses of a new product line, so long as such amounts were estimated in the same manner as would be computed under GAAP; and
- Measures of profit or loss and total assets for each segment required to be disclosed in accordance with GAAP.

Liability under Regulation G and the Exchange Act

If a company fails to comply with Regulation G, the company and /or the person acting on its behalf could be subject to an SEC enforcement action alleging violations of Regulation G. Additionally, if the facts and circumstances warrant, the SEC could bring an action under both Regulation G and Rule 10b-5.

Non-GAAP Financial Measures in SEC Filings

At the same time that it adopted Regulation G, the SEC also adopted rules that amend Item 10 of Regulation S-K, Item 10 of Regulation S-B and Form 20-F. These new rules require companies using non-GAAP financial measures in SEC filings to:

- Present the most directly comparable GAAP financial measure and a quantitative reconciliation of the GAAP and non-GAAP measures;
- Ensure that the presentation of the comparable GAAP financial measure is of equal or greater prominence than the non-GAAP financial measure;
- Disclose the reasons why the company's management believes that presentation of the non-GAAP financial measure provides useful information to investors regarding the company's financial condition and results of operations; and
- To the extent material, disclose the additional purposes, if any, for which the company's management uses the non-GAAP financial measure that are not otherwise disclosed.

In addition to these mandated disclosure requirements, the amendments to Item 10 of Regulation S-K and Regulation S-B *prohibit* the following:

- Including financial measures that exclude charges or liabilities that require cash settlement from non-GAAP liquidity measures, other than the measures EBIT and EBIT-DA;
- Adjusting a non-GAAP performance measure to eliminate or smooth non-recurring, infrequent or unusual items, 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 the company's financial statements, 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 II 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.

The requirements and prohibitions regarding the use of non-GAAP financial measures in filings with the SEC are more extensive and detailed than those of Regulation G. However, the final rules do permit the use of non-GAAP per share measures in filings with the SEC.



Disclosing Off-Balance Sheet Arrangements and Aggregate Contractual Obligations in MD&A

On January 22, 2003 the SEC adopted final rules requiring a company to provide an explanation of its off-balance sheet arrangements in a separately captioned subsection of the MD&A for all filings that include financial statements for fiscal years ending on or after June 15, 2003. The final rules also require companies (other than small business issuers) to provide a tabular overview of certain contractual obligations in filings that include financial statements for fiscal years ending on or after December 15, 2003.

Definition of “Off-Balance Sheet Arrangement”

The definition of “off-balance sheet arrangement” includes any contractual

arrangement to which an unconsolidated entity is a party, under which the company has:

- Any obligation under certain guarantee contracts with the characteristics of those covered by FASB Interpretation No. 45;
- A retained or contingent interest in assets transferred to an unconsolidated entity or similar arrangement that serves as credit, liquidity or market risk support to that entity for such assets;
- Any obligation under certain derivative instruments that are excluded from FASB Statement of Financial Accounting Standards No. 133, and those that are both indexed to the company’s own stock and classified as stockholders’ equity; and
- Any obligation under a material variable interest, as defined in FASB Interpretation No. 46, in an unconsolidated entity that provides financing, liquidity, market risk or credit risk support to the company, or engages in leasing, hedging or research and development services with the company.

Disclosure of “Off-Balance Sheet Arrangements”

The final rules require a company to disclose off-balance sheet arrange-

ments that have, or are reasonably likely to have, a current or future effect on the company’s financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors. This disclosure threshold is consistent with the standard applicable to other portions of the MD&A.

The final rules require a company to disclose the following information to the extent necessary to provide investors with an understanding of a company’s off-balance sheet arrangements and their material effects:

- Nature and business purpose of the off-balance sheet arrangements;
- Importance of its off-balance sheet arrangements to its liquidity, capital resources, market risk support, credit risk support or other benefits;
- Overall magnitude of a company’s off-balance sheet arrangements, the specific material impact of the off-balance sheet arrangements on a company, and the circumstances that could cause material contingent obligations or liabilities to come to fruition;
- Amounts of revenues, expenses and cash flows of the company arising from the arrangements;

- Nature and total amount of any interests retained, securities issued and other indebtedness incurred by the company in connection with such arrangements;
- Nature and amount of any other obligations or liabilities (including contingent obligations or liabilities) of the company arising from the arrangements that are, or are reasonably likely to become, material and the triggering events or circumstances that could cause them to arise;
- Any known event, demand, commitment, trend or uncertainty that will, or is reasonably likely to, result in the termination or material reduction in availability to the company, of its off-balance sheet arrangements that provide the company with material benefits; and
- Such other information the company believes is necessary for an understanding of its off-balance sheet arrangements and their material effects.

A company’s disclosure regarding off-balance sheet arrangements should generally cover the most recent fiscal year, but it also should address changes from the previous year, to the extent necessary to permit an understanding of the arrangement.

Tabular Summary of Contractual Obligations

The SEC's new rules require companies (other than small business issuers) to provide

a tabular summary of the payments due under their contractual obligations, aggregated by category of contractual obligation, for specified time periods, as of the latest fiscal year end balance sheet date.

The tabular summary should be accompanied by any footnotes necessary to describe material contractual provisions to the extent necessary for an understanding of the timing and amount of the contractual obligations. Unlike the off-balance sheet arrangement disclosure, which must be disclosed in a separately-captioned section of the MD&A, this tabular summary may be included anywhere in the MD&A that the company deems appropriate.

Safe Harbor for Forward-Looking Information

The final rules explicitly apply the statutory safe harbor protections of the Private

Securities Litigation Reform Act of 1995 to forward-looking information regarding off-balance sheet arrangements and contractual obligations. The safe harbor provides that a forward-looking statement will be protected from private legal actions that are based on allegations of a material misstatement or omission, if it is identified as forward-looking, and is accompanied by meaningful cautionary statements that identify important factors that could cause actual results to differ materially from those in the forward-looking statement. Moreover, the final rules specify that companies that comply with all of the disclosure requirements regarding off-balance sheet arrangements will satisfy the statutory safe harbor's requirement to provide meaningful cautionary statements.



Applicability to Foreign Private Issuers

Earnings Releases

Foreign private issuers will not be required to furnish earnings releases on Form 8-K.

Non-GAAP Financial Measures

Regulation G will apply to any company that is a foreign private

issuer, unless:

- Its securities are listed or quoted outside of the United States;
- The non-GAAP financial measure is not derived from or based on a measure calculated and presented in accordance with U.S. GAAP; and
- The disclosure is made outside of the United States, or is included in a written communication that is released outside of the United States. This exception will apply even if (i) a contemporaneous or later public disclosure is made in the United States, or the information appears on one or more web sites maintained by the company, as long as the disclosure is not targeted at persons located in the United States; or (ii) following the disclosure or release of the information outside the United States, the information is included in a submission to the SEC made under cover of a Form 6-K.

Generally, as used in Regulation G, GAAP refers to U.S. GAAP. In the case of foreign private issuers whose primary financial statements are prepared in accordance with non-U.S. GAAP, Regulation G expressly provides that GAAP refers to the principles under which those primary financial statements are prepared. In the case of foreign private issuers that include a non-GAAP financial measure derived from or based on a U.S. GAAP measure, Regulation G expressly provides that GAAP refers to U.S. GAAP for purposes of the application of the requirements of Regulation G to the disclosure of that measure.

**Non-GAAP
Financial
Measures in
Filings with
the SEC**

Foreign private issuers will be subject to the same requirements as domestic issuers with respect to the use of non-GAAP financial measures in filings with the SEC on Form 20-F. In this context, the definition of “non-GAAP financial measures” is the same as under Regulation G. However, a non-GAAP financial measure that would otherwise be prohibited will be permitted in a Form 20-F filing if the measure is **(i)** included in the foreign private issuer's annual report or financial statements used in its home country jurisdiction or market and **(ii)** required or expressly permitted by the standard-setter that establishes the generally accepted accounting principles used in the foreign private issuer's primary financial statements. This exception does not cover situations where the measure is merely not prohibited by said standard-setter.

**MD&A
Disclosure of
Off-Balance
Sheet
Arrangements
and
Contractual
Obligations**

The final rules pertaining to MD&A disclosure of off-balance sheet arrangements and contractual obligations apply to foreign private issuers who file annual reports on Form 20-F or Form 40-F. Note that the final rules pertaining to MD&A disclosure do not apply to reports on Form 6-K. Foreign private issuers whose primary financial statements are prepared in accordance with non-U.S. GAAP should include in their MD&A a discussion of the reconciliation to U.S. GAAP, and any differences between foreign and U.S. GAAP, if it would be necessary for an understanding of the financial statements as a whole.

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