

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

SECURITIES ACT OF 1933

Release No. 5520/August 14, 1974

SECURITIES EXCHANGE ACT OF 1934

Release No. 10961/August 14, 1974

ACCOUNTING SERIES RELEASE

Release No. 159/August 14, 1974

NOTICE OF ADOPTION OF AMENDMENTS TO GUIDE 22 OF THE
GUIDES FOR PREPARATION AND FILING OF REGISTRATION
STATEMENTS UNDER THE SECURITIES ACT OF 1933 AND
ADOPTION OF GUIDE 1 OF THE GUIDES FOR PREPARATION
AND FILING OF REPORTS AND REGISTRATION STATEMENTS
UNDER THE SECURITIES EXCHANGE ACT OF 1934
(Textual Analysis of Summary of Earnings or
Operations)

Effective Date: September 30, 1974

The Securities and Exchange Commission today authorized the adoption of amendments to Guide 22, "Summary of Earnings," of the Guides for Preparation and Filing of Registration Statements under the Securities Act of 1933 ("Securities Act"). The Commission also authorized the adoption of Guide 1, "Summary of Operations," of Guides for Preparation and Filing of Reports and Registration Statements under the Securities Exchange Act of 1934 ("Exchange Act"). These Guides are not rules of the Commission nor are they published as bearing the Commission's official approval; they represent policies and practices followed by the Commission's Division of Corporation Finance and, in this instance, the Commission's Office of the Chief Accountant in administering the disclosure requirements of the federal securities laws. The proposals to amend Guide 22 under the Securities Act and adopt Guide 1 under the Exchange Act were originally published for comment on December 19, 1972 (Securities Act Release No. 5342) and then were reissued in revised form for additional comment on December 12, 1973 (Securities Act Release No. 5442). These Guides will require disclosure to clarify and explain the financial information called for by the Summary of Earnings and Statement of Income items of certain forms under the Securities Act and similar summaries required by certain forms under the Exchange Act.

The relevant forms under the Securities Act provide in part that, in addition to the columnar presentation of summary financial data, registrants must supply information of material significance to investors in appraising the results shown. Securities Act Guide 22, as amended, indicates the type of supplementary information needed to explain periodic changes in financial data included in the Summary of Earnings. In order to apply disclosure standards similar to those required by Securities Act Guide 22, as amended, to filings under the Exchange Act, the new Exchange Act Guide 1 is adopted.

In issuing the Guides for additional comment in December 1973, the Commission pointed out that it has long recognized the need for narrative explanation of financial statements. Over the years the rules under the various securities acts have been amended a number of times to require additional narrative disclosure of complex financial transactions. Securities Act Guide 22 and Exchange Act Guide 1 require an explanation of the Summary of Earnings and Summary of Operations to enable investors to appraise the quality of earnings. Investors should understand the extent to which accounting changes, as well as changes in business activity, have affected the comparability of year-to-year data and should be in a position to assess the source and probability of recurrence of net income (or loss). Thus, whenever there are material changes in the amount and source of revenues and expenses, including tax expenses, or changes in accounting principles or methods or their application that have a material effect on net income, an appropriate analysis and explanation is required. In addition, this analysis should include a discussion of material facts, whether favorable or unfavorable, required to be disclosed or disclosed in the prospectus, registration statement, or report which in the opinion of management may make historical operations or earnings as reported in the summary of earnings not indicative of current or future operations or earnings.

Some commentators on the revised Guides felt that the standards for determining materiality were too inclusive and that items that were not material would still fall within the percentage test set forth in the Guides. The Guides, as adopted, provide that if in management's opinion an explanation of a change is not necessary to an understanding of the summary of earnings even though the change meets the percentage tests set forth in the Guides, the issuer should furnish the Division as supplemental information, a written statement of the reasons for such opinion. On the other hand, if the issuer believes an explanation of a change is necessary to an understanding of the summary, it should be given notwithstanding the fact that the change does not meet such percentage tests. For example, if sales and net earnings increased only .2% in the most recent period after having increased by 10% or more in previous periods an explanation of the .2% change would be appropriate. Also in response to comments, the Guides as finally adopted limit the issuer's explanation of material periodic revenue and expense item changes to changes beginning

after the third most recent fiscal year of the Summary of Earnings (Summary of Operations) and provide that this explanation of material periodic changes in revenues and expenses be included in a section captioned "Management's Discussion and Analysis of the Summary of Earnings" immediately following the Summary of Earnings (Summary of Operations).

A number of commentators also objected to the requirement that management discuss facts that would indicate that historical earnings were not indicative of present and future earnings. Difficulty in deciding what "facts" would have to be included and in presenting forward looking information were cited. These comments have been taken into consideration in revising the Guides, which as adopted require discussion of only material facts required to be disclosed or disclosed in the relevant document which, in management's opinion, may make historical operations or earnings not indicative of current or future operations or earnings. The discussion called for would be in broad terms only; no specific quantitative estimates or projections would be required. Commentators also raised the question whether the Guide calls for disclosure relating to anticipated changes in the trend of earnings or in absolute numbers. Depending on the facts and circumstances, discussion of material facts indicating changes in either absolute amounts or in trends would be required.

It should be noted that the disclosures proposed would be in addition to "Information as to Lines of Business" called for by Item 9(b) of Form S-1 and Item 5(b)(1) of Form S-7 under the Securities Act and similar disclosure required by Item 1(c)(1) of Forms 10 and 10-K under the Exchange Act.

The text of Securities Act Guide 22 is set forth below, with changes from the existing guide underlined and deletions bracketed. Exchange Act Guide 1 is also set forth below.

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Guide 22 Summary of Earnings

(Note: This Guide applies to the items of the registration forms under the Act that provide for a Summary of Earnings, Statement of Income, Summary Financial Data, or Condensed Financial Information, i.e., Forms S-1, S-7, S-8, S-9, S-11 and S-14).

(a) The content of the Summary of Earnings is specified in general in the instructions to the pertinent items of the form. The necessity of disclosing items in addition to those specified in such instructions will depend upon the circumstances. These instructions cannot, of course, cover all situations which may arise nor is it practicable to set forth a Guideline dealing specifically with all possible situations. ~~(The-existence-of any-unusual-conditions-affecting-the-propriety-of-the~~

~~presentation-and-the-necessity-for-the-inclusion-of-an-additional-previous period-should-be-considered).~~

(b) To enable investors to understand and evaluate material periodic changes in the various items of the summary of earnings, a separately captioned section (entitled "Management's Discussion and Analysis of the Summary of Earnings") immediately following such summary should include a statement explaining (1) material changes from period to period in the amounts of the items of revenues and expenses, and (2) changes in accounting principles or practices or in the method of their application that have a material effect on net income as reported. The purpose of this statement is to provide investors with management's analysis of the financial data included in the summary through a discussion of the causes of material changes in the items of the summary and of disclosure of the dollar amount of each such change and the effect of each such change on the reported results for the applicable periods. This discussion is necessary to enable investors to compare periodic results of operations and to assess the source and probability of recurrence of earnings (losses). The analysis should include a discussion of material facts, whether favorable or unfavorable, required to be disclosed or disclosed in the prospectus which, in the opinion of management, may make historical operations or earnings as reported in the summary of earnings not indicative of current or future operations or earnings.

(c) In general, the discussion of material periodic changes should be limited to: (1) the latest interim period presented and the comparable interim period in the immediately preceding fiscal year; (2) the most recent fiscal year presented and the fiscal year immediately preceding it; and (3) the second most recent fiscal year presented and the fiscal year immediately preceding it. There may be circumstances, however, under which an explanation of revenue or expense item changes between two or more of the earlier periods of the five year summary may be material to an understanding of the summary. Further, to better explain revenue and expense item changes for interim periods it may be necessary to give an analysis of changes between consecutive fiscal quarters.

(d) While it is not feasible to specify all subjects which should be covered in the discussion and analysis of the summary, the following are examples which registrants should consider in making disclosure:

1. Material changes in product mix or in the relative profitability of lines of business;
2. Material changes in advertising, research, development, product introduction or other discretionary costs;
3. The acquisition or disposition of a material asset other than in the ordinary course of business;
4. Material and unusual charges or gains, including credits or charges associated with discontinuation of operations;

5. Material changes in assumptions underlying deferred costs and the plan for amortization of such costs;
6. Material changes in assumed investment return and in actuarial assumptions used to calculate contributions to pension funds; and
7. The closing of a material facility or material interruption of business or completion of a material contract.

(e) The textual analysis should be presented in a manner that will best communicate the significant elements necessary to a clear understanding by the investor of the financial results. Favorable as well as unfavorable trends and changes should be discussed. Tables and charts may be used where appropriate. A mechanistic approach to this analysis which uses boiler plate or compliance jargon should be avoided.

(f) For purposes of this Guide discussion of a change in an item of revenue or expense generally is required when an item required to be set forth in the summary or disclosed pursuant to Rule 12-16 of Regulation S-X increased or decreased by more than 10% as compared to the prior period (but only if such prior period is presented), and increased or decreased by more than 2% of the average net income or loss for the most recent three years presented. In calculating average net income, loss years should be excluded. If losses were incurred in each of the most recent years, the average loss shall be used for purposes of this test. Should the issuer be of the opinion that an explanation of a change is not necessary to an understanding of the summary even though the change meets the foregoing standards, the issuer shall furnish the Division, as supplemental information, a written statement of the reasons for the omission.

Note: If an income statement in the form prescribed by Regulation S-X is used in lieu of the summary, then the discussion should cover the period to period changes in revenue and expense items required by such Regulation.

(g) Notwithstanding the fact that a change in an item of revenue or expense does not meet the standards set forth in paragraph (f), it should be discussed if the issuer believes an explanation of such a change is necessary to an understanding of the summary.

(h) When the text of the prospectus contains a discussion of factors indicating a (an-adverse) material change in operating results, whether favorable or unfavorable subsequent to the latest period included in the summary of operations, the (summary) management discussion and analysis should call attention to the change (in-a-headnote-or-a-footnote) and refer to the place in the prospectus where it is discussed.

Guide 1 Summary of Operations

(a) The content of the summary of operations is specified in general in the instructions to the pertinent items of Forms 10 and 10-K. The necessity of disclosing items in addition to those specified in such instructions will depend upon the circumstances. These instructions cannot, of course, cover all situations which may arise nor is it practicable to set forth a Guideline dealing specifically with all possible situations.

(b) To enable investors to understand and evaluate material periodic changes in the various items of the summary of operations, a separately captioned section (entitled "Management's Discussion and Analysis of The Summary of Operations") immediately following such summary should include a statement explaining (1) material changes from period to period in the amounts of the items of revenues and expenses, and (2) changes in accounting principles or practices or in the method of their application that have a material effect on net income as reported. The purpose of this statement is to provide investors with management's analysis of the financial data included in the summary through a discussion of the causes of material changes in the items of the summary and of disclosure of the dollar amount of each such change and the effect of each such change on the reported results for the applicable periods. This discussion is necessary to enable investors to compare periodic results of operations and to assess the source and probability of recurrence of earnings (losses). The analysis should include a discussion of material facts, whether favorable or unfavorable, required to be disclosed or disclosed in the registration statement or report which, in the opinion of management, may make historical operations or earnings as reported in the summary of operations not indicative of current or future operations or earnings.

(c) In general, the discussion of material periodic changes should be limited to: (1) the latest interim period presented and the comparable interim period in the immediately preceding fiscal year; (2) the most recent fiscal year presented and the fiscal year immediately preceding it; and (3) the second most recent fiscal year presented and the fiscal year immediately preceding it. There may be circumstances, however, under which an explanation of revenue or expense item changes between two or more of the earlier periods of the five year summary may be material to an understanding of the summary. Further, to better explain revenue and expense item changes for interim periods it may be necessary to give an analysis of changes between consecutive fiscal quarters.

(d) While it is not feasible to specify all subjects which should be covered in the discussion and analysis of the summary, the following are examples which registrants should consider in making disclosure:

1. Material changes in product mix or in the relative profitability of lines of business;
2. Material changes in advertising, research, development, product introduction or other discretionary costs;
3. The acquisition or disposition of a material asset other than in the ordinary course of business;
4. Material and unusual charges or gains, including credits or charges associated with discontinuation of operations;
5. Material changes in assumptions underlying deferred costs and the plan for amortization of such costs;
6. Material changes in assumed investment return and in actuarial assumptions used to calculate contributions to pension funds; and
7. The closing of a material facility or material interruption of business or completion of a material contract.

(e) The textual analysis should be presented in a manner that will best communicate the significant elements necessary to a clear understanding by the investor of the financial results. Favorable as well as unfavorable trends and changes should be discussed. Tables and charts may be used where appropriate. A mechanistic approach to this analysis which uses boiler plate or compliance jargon should be avoided.

(f) For purposes of this Guide discussion of a change in an item of revenue or expense generally is required when an item required to be set forth in the summary or disclosed pursuant to Rule 12-16 of Regulation S-X increased or decreased by more than 10% as compared to the prior period (but only if such prior period is presented), and increased or decreased by more than 2% of the average net income or loss for the most recent three years presented. In calculating average net income, loss years should be excluded. If losses were incurred in each of the most recent years, the average loss shall be used for purposes of this test. Should the issuer be of the opinion that an explanation of a change is not necessary to an understanding of the summary even though the change meets the foregoing standards, the issuer shall furnish the Division, as supplemental information, a written statement of the reasons for the omission.

Note: If an income statement in the form prescribed by Regulation S-X is used in lieu of the summary, then the discussion should cover the period to period changes in revenue and expense items required by such Regulation.

(g) Notwithstanding the fact that a change in an item of revenue or expense does not meet the standards set forth in paragraph (f), it should be discussed if the issuer believes an explanation of such a change is necessary to an understanding of the summary.

(h) When the text of the registration statement or report contains a discussion of factors indicating a material change in operating results, whether favorable or unfavorable, subsequent to the latest period included in the summary of operations, the management discussion and analysis should call attention to the change and refer to the place in the registration statement or report where it is discussed.

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The Commission has authorized the adoption of Guide 22 and Guide 1 pursuant to authority in Sections 6, 7, 10 and 19(a) of the Securities Act, as amended, and Sections 12, 13, 15(d) and 23(a) of the Exchange Act, as amended. The amendments will be effective September 30, 1974 and will apply to registration statements under the Securities Act and to reports and registration statements under the Exchange Act filed on or after that date, but not to such registration statements and reports filed before that date.

By the Commission.

George A. Fitzsimmons
Secretary