

defining issues[®]

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More Form 8-K Disclosures, Less Filing Time

Public companies will have to report eight more events on Form 8-K, some calling for difficult judgments about when events become reportable, and will have to file in four business days in most cases, according to a new SEC rule that is effective August 23, 2004.¹ Companies could find meeting the accelerated deadlines in tension with achieving the quality and accuracy of the information disclosed and will have to determine whether many of the new 8-K events are “material” and therefore must be disclosed.

The new rule is consistent with Section 409 of the Sarbanes-Oxley Act of 2002, which requires material information to be disclosed “on a rapid and current basis.” This edition of *Defining Issues* describes the rule’s filing deadlines, the new events that trigger current disclosure requirements, and the rule’s limited safe-harbor provisions. Companies should consult their securities counsel when determining the nature and timing of events that should be disclosed under the new rule and the appropriate disclosures.

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(1) Release No. 33-8400, Additional Form 8-K Disclosure Requirements and Acceleration of Filing Date, March 16, 2004, <http://www.sec.gov/rules/final/33-8400.htm>.

TIGHTER DEADLINES

Qualifying events, including those previously required to be disclosed (e.g., change in independent accountants and acquisition or disposition of assets), will have to be reported on Form 8-K within four business days, down from within five or fifteen days under prior rules. The four-business-day deadline does not apply to disclosures under Regulation FD, voluntary disclosures, and certain exhibits.²

The new rule reduces the time to report a material business acquisition to four days from consummation of the acquisition. However, the extension period for filing the related financial statements and pro forma information has been lengthened to 71 days, thereby preserving the current 75-day total period to file the financial statements (four days for filing the acquisition event on Form 8-K plus 71 days to file the financial statements).

The rule transfers two disclosure items from other filing requirements to Form 8-K's filing requirements, shortening the time to make the disclosures. Sales of a company's equity securities in an unregistered transaction (or an earlier enforceable sales agreement) trigger the Form 8-K disclosure requirements if the sales exceed certain quantitative thresholds. Material modifications to the rights of holders of any class of the company's registered securities must also be reported on Form 8-K when the new rule becomes effective.

NEW DISCLOSURES

The following additional events will have to be disclosed within the four-business-day deadline if they meet the described triggering conditions.

Entry into a Material Definitive Agreement—Triggering condition: The company enters into an agreement not in the ordinary course of business that creates obligations or rights that are material and legally enforceable (or the company amends a pre-existing agreement that produces the same effect). This generally excludes the execution of a letter of intent or other non-binding agreement.

The required disclosures triggered by this event include the parties to the agreement, their relationship to the company, and the agreement's date, terms, and conditions.

Termination of a Material Definitive Agreement—Triggering condition: An agreement entered into by the company not in the ordinary course of business is terminated, and the effect of the termination is material to the company. Simple expiration or completion of the obligation associated with an agreement does not trigger disclosure. The required disclosures triggered by this event include the agreement's terms, conditions, and termination date, the parties to the agreement, their relationship to the company, the circumstances of the termination, and any material early termination penalties incurred.

Creation of a Direct Financial Obligation or an Obligation under an Off-Balance-Sheet Arrangement of a Registrant—Triggering condition: A company becomes obligated under a "direct financial obligation," defined as a short-term obligation other than in the ordinary course of business, a long-term debt obligation, or a capital or operating lease obligation, that is material to the company. This includes entering into a facility or program that creates or *may* give rise to a material direct financial obligation in connection with multiple transactions, and when material obligations actually arise under the arrangement. The required disclosures under this item include the date the company becomes obligated, a description of the transaction, the amount of the obligation, the terms under which the agreement may be accelerated or increased, and other material terms and conditions.

This event also includes the company's becoming directly or contingently liable for an obligation that is material to the company from an off-balance-sheet arrangement, whether or not the company is a party to the transaction that creates the contingent obligation.³ If the company is not a party to the transaction, the four-day disclosure deadline would be based on other triggers, including when an executive officer becomes aware of the contingent obligation. A company that identifies this triggering event would have to disclose the maximum

(2) Release No. 33-7881, *Selective Disclosure and Insider Trading*, August 15, 2000.

(3) See the definition of the term off-balance-sheet arrangement in Release No. 33-8182, *Disclosure in Management's Discussion and Analysis about Off-Balance Sheet Arrangements and Aggregate Contractual Obligations*, January 28, 2003.

potential amount of future payments (without offset by amounts possibly recoverable from others) and make other disclosures similar to those described in the previous paragraph.

Triggering Events that Accelerate or Increase a Direct Financial Obligation or an Obligation under an Off-Balance-Sheet Arrangement—Triggering condition: An event of default or acceleration that will increase or accelerate a direct financial obligation, or an off-balance-sheet-arrangement obligation, that has material consequences for the company. This event also includes a default that causes an off-balance-sheet-arrangement obligation to become a direct financial obligation, such as when an amount related to that obligation is recorded as a probable loss contingency under GAAP.⁴ When this type of default event occurs, companies would describe the transaction and the triggering event (including the triggering event's date), the nature and amount of the obligation, and any other material obligations of the company that *may* arise, increase, be accelerated, or become direct financial obligations as a result of the default (e.g., a loan agreement that specifies that a default under any agreement causes a default under the loan agreement).

Companies could find it challenging to identify the event triggering a disclosure requirement promptly in the case of cross-defaults. It could also be challenging to determine when off-balance-sheet obligations must be accrued as probable loss contingencies, because the circumstances might be fully assessed only during the subsequent financial-statement reporting process. Companies may also find it challenging to assess whether the default event is material to the company, because the assessment must consider any other material obligations coming about as a result of the default.

Costs Associated with Exit or Disposal Activities—Triggering condition: The board of directors, its committee, or a fully authorized officer commits the company to dispose of assets or operations under a “plan of termination,” and material charges will have to be recorded in the financial statements under GAAP.⁵

The company would have to disclose the commitment date, the expected completion date, a description of the course of action, an estimate of the total amount or range of amounts expected to be incurred for each major type of cost and in total for the event, and an estimate or range of amounts resulting in future cash expenditures. A company that is unable to make a good faith estimate of the charges at the time of the filing would be permitted to file an amended Form 8-K with the quantitative disclosures four business days after formulating the estimate.

We anticipate that in some circumstances companies will find it difficult to provide accurate and meaningful disclosures for exit events because disclosure on Form 8-K could be triggered before the related amounts are reported in the financial statements. Under Statement 146, a company's commitment to a plan does not by itself create a liability that must be recognized in the financial statements. A liability may be recognized at a date much later than the date the board commits to a plan, and under Statement 146 there might be more than one liability measurement and recognition date for an exit event.

Material Impairments—Triggering condition: The board of directors, its committee, or a fully authorized officer concludes that a material impairment charge to an asset is required under GAAP. The company should disclose the date of the conclusion, a description of the impaired assets, events leading up to the impairment, and estimates of the amount or range of amounts of the impairment charge and the amount that will result in future cash expenditures.

A company that is unable to make a good faith estimate of the impairment charge at the time of the filing would be permitted to file an amended Form 8-K with the quantitative disclosures four business days after the company formulates the estimate. No Form 8-K would be necessary if the board's conclusion on a material impairment is made in connection with the preparation, review, or audit of annual or quarterly financial statements *and* the conclusion is disclosed on a timely basis in that periodic filing report.

(4) FASB Statement of Financial Accounting Standards No. 5, *Accounting for Contingencies*, March 1975.

(5) FASB Statement of Financial Accounting Standards No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*, June 2002. Paragraph 8 refers to the establishment of a plan of termination and describes its characteristics (in the context of determining whether a one-time benefit arrangement exists). They include: the plan establishes the terms of the arrangement in sufficient detail to enable employees to determine the type and amount of benefits they will receive if they are involuntarily terminated and identifies the number of employees to be terminated, their job classifications or functions and their locations, and the expected completion date.

Notice of Delisting or Failure to Satisfy a Continued Listing Rule or Standard, Transfer of Listing—Triggering condition: With respect to the principal listing of any class of a company's common equity, the company receives notice of delisting matters or the company notifies the listing body or takes other actions regarding delisting matters. This event includes delisting in connection with transferring a listing to a different securities exchange. The required disclosures for this triggering event include the date of notification, the applicable rule that has not been met, and any action that the company has determined to take in response to the notice.

Non-Reliance on Previously Issued Financial Statements or a Related Audit Report or Completed Interim Review—Triggering condition: The board of directors, its committee, or a fully authorized officer concludes that previously issued financial statements for interim or annual periods should no longer be relied on because of an error in applying GAAP, or an independent auditor notifies the company that it should take action to prevent future reliance on a previously issued audit report or completed interim review of previously issued financial statements.

The disclosures called for are similar for both instances, including a brief description of the facts underlying the board's conclusion or independent auditor's notification and a statement indicating whether the audit committee discussed the matter with the auditors. If the disclosure requirement is triggered by auditor notification, the company gives the auditor its disclosures no later than the day it files its Form 8-K, requests the auditor to provide a letter as promptly as possible stating whether the auditor agrees with the disclosures and, if not, identifying the disclosures it disagrees with. The company then amends its Form 8-K to include the auditor's letter as an exhibit within two business days of receipt.

The new rule expands the scope of two existing Form 8-K triggering events and the related disclosures.

Departure of Directors or Principal Officers, Election of Directors, Appointment of Principal Officers—The scope of this triggering event is being significantly expanded to include director departures for any reason and the election of a new director without a vote of shareholders. Increased disclosures would have to be made if there is a disagreement between the director and the company. Disclosure has previously been required only when a director departs because of a disagreement and the director provides a letter and requests disclosure. The new rule also adds required disclosure when specified principal officers are appointed or terminated, retire, or resign.

Amendments to Articles of Incorporation or Bylaws, Change in Fiscal Year—The scope of this triggering event is being expanded to include amendments by a company with registered equity securities to its articles of incorporation or bylaws if the amendment was not proposed in a previously filed proxy or information statement.

LIMITED SAFE HARBOR

Companies would be protected by a limited safe harbor from potential liability under Exchange Act Section 10(b) and Rule 10b-5 for untimely filing of a Form 8-K. The safe harbor applies only to new disclosure items noted above and then not to all of them. It excludes the new disclosure obligations on delisting from an exchange and non-reliance on financial statements when notified by the independent auditor. However, the safe harbor does not protect violators from Section 10(b) and Rule 10b-5 liability for failure to satisfy a separate duty to disclose that information. Nor does it provide protection from liability for material misstatements or omissions in a filed Form 8-K.

The safe harbor allows a company to maintain its eligibility to use Form S-2 and S-3 registration statements as long as the information required under Form 8-K for the items covered by the safe harbor is filed no later than the due date of the registrant's periodic report (e.g., on Form 10-Q) for the period that includes the event requiring disclosure (by including the information in that periodic report). All disclosure required on Form 8-K would have to be filed with the SEC before a Form S-2 or Form S-3 is filed.

FORM 8-K'S REORGANIZATION

The new rule reorganizes Form 8-K, using the following section headings and numbering, which will be used for filings when the amendments are effective:

Section 1 – Registrant's Business and Operations

- Item 1.01 Entry into a Material Definitive Agreement
- Item 1.02 Termination of a Material Definitive Agreement
- Item 1.03 Bankruptcy or Receivership

Section 2 – Financial Information

- Item 2.01 Completion of Acquisition or Disposition of Assets
- Item 2.02 Results of Operations and Financial Condition
- Item 2.03 Creation of a Direct Financial Obligation or an Obligation under an Off-Balance Sheet Arrangement of a Registrant
- Item 2.04 Triggering Events That Accelerate or Increase a Direct Financial Obligation or an Obligation under an Off-Balance Sheet Arrangement
- Item 2.05 Costs Associated with Exit or Disposal Activities
- Item 2.06 Material Impairments

Section 3 – Securities and Trading Markets

- Item 3.01 Notice of Delisting or Failure to Satisfy a Continued Listing Rule or Standard; Transfer of Listing
- Item 3.02 Unregistered Sales of Equity Securities
- Item 3.03 Material Modifications to Rights of Security Holders

Section 4 – Matters Related to Accountants and Financial Statements

- Item 4.01 Changes in Registrant's Certifying Accountant
- Item 4.02 Non-Reliance on Previously Issued Financial Statements or a Related Audit Report or Completed Interim Review

Section 5 – Corporate Governance and Management

- Item 5.01 Changes in Control of Registrant
- Item 5.02 Departure of Directors or Principal Officers; Election of Directors, Appointment of Principal Officers
- Item 5.03 Amendments to Articles of Incorporation or Bylaws; Change in Fiscal Year
- Item 5.04 Temporary Suspension of Trading Under Registrant's Employee Benefit Plans
- Item 5.05 Amendments to the Registrant's Code of Ethics, or Waiver of a Provision of the Code of Ethics

Section 6 – [Reserved]

Section 7 – Regulation FD

- Item 7.01 Regulation FD Disclosure

Section 8 – Other Events

- Item 8.01 Other Events

Section 9 – Financial Statements and Exhibits

- Item 9.01 Financial Statements and Exhibits



CHANGES FROM 2002 PROPOSAL

The most significant change from the 2002 proposal is to allow four business days to file most Form 8-K items, rather than two business days with an automatic two-day extension.⁶ The final rule also excludes some proposed disclosure requirements, such as change in a rating-agency decision, issuance of a credit watch, or a change in a company's outlook, because those items are being considered in a separate SEC project. Disclosure of termination or reduction of a business relationship with a customer was dropped after consideration of comments received on the proposal.

APPLICABILITY

The amendments to Form 8-K apply to small business issuers, but do not amend Form 6-K for foreign private issuers.



Affected companies have six months to become familiar with the new reporting requirements, which come into effect August 23, 2004. Companies will also want to consider the effectiveness of their disclosure controls and procedures to make current disclosures within the accelerated deadlines.

The summary statements above describing SEC Release No. 33-8400 should not be understood as a complete account of the release and should not be substituted for its text. No statements should be assumed to apply to the specific circumstances facing any particular company. In all matters related to SEC rules and regulations, companies should consult the relevant, applicable requirements and their accounting and legal advisors.

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⁽⁶⁾ Release No. 33-8106, Additional Form 8-K Disclosure Requirements and Acceleration of Filing Date, June 17, 2002, www.sec.gov/rules/proposed/33-8106.htm.