

SEC to Charge Company With Misleading 'Pro Formas' (Update2)

(Adds date of Pitt comment in second paragraph.)

Washington, Dec. 18 (Bloomberg) -- The Securities and Exchange Commission will soon file civil charges against a company for misleading investors by using pro forma accounting, SEC Chairman Harvey Pitt said.

"I suspect, given what we've seen, that there will be some enforcement activity," he said in an interview last Tuesday. "Meaning a real case." Pitt, who has headed the federal agency since August, declined to name the company to be charged.

The case will be the first filed by the SEC over companies' use of figures that typically make earnings look better by excluding some costs, former SEC officials said.

"This case will send a message to companies and accountants to cut back on some of the games they've been playing, and it shows that Harvey Pitt is serious about the quality of financial reporting," said former SEC General Counsel Harvey Goldschmid.

The reliability and accuracy of company financial reports are being questioned by Congress after Enron Corp.'s collapse and the apparent failure of its auditor, Arthur Andersen LLP, to detect financial irregularities. The Houston-based energy trader, which filed the biggest Chapter 11 bankruptcy ever, admitted overstating earnings by \$586 million over five years.

Cisco Systems Inc. and Amazon.com Inc. are among hundreds of technology companies that have issued pro forma earnings highlighting what they call their core performance. These reports, prepared differently than required by U.S. accounting rules, are sometimes issued in press releases that can cause the stock to rise and are

followed weeks later by official results that can prompt shares to fall.

Warning Investors

The SEC's enforcement case will give teeth to its threat last week to file civil fraud charges against companies that mislead investors with pro forma earnings, said Goldschmid, now a Columbia University law professor. The SEC also warned investors to view pro forma reports with suspicion.

Pro forma figures can be legal as long as they don't mislead investors. Possibly illegal pro forma results would be those that omit important information or address "a limited feature" of a company's results without disclosing the underlying financial basis, the SEC said last week.

"If reported earnings under generally accepted accounting principles are presented side by side with pro formas, and there's a reconciliation, and it's clear the investor can see the difference between them, I think that's okay," said former SEC Chief Accountant Walter Schuetze.

Pitt, 56, has said the SEC is investigating a number of cases of pro forma accounting, which can exclude costs involving mergers, non-cash compensation and in-process research and development.

Steering Clear

The SEC's enforcement case will be the first alleging misleading use of pro forma results, said Goldschmid and former SEC Chief Accountant Lynn Turner. Other companies that have issued pro forma earnings include Procter & Gamble Co., SCI Systems Inc. and Yahoo! Inc.

"The case will send a message that companies are probably best off if they steer clear of pro forma earnings entirely," said

Turner, now a Colorado State University accounting professor.

Schuetze said, though, that pro forma earnings still "have a place," and many companies agree.

Seattle-based Amazon, the biggest Internet retailer, releases its pro forma results at the same time it files its earnings under generally accepted accounting principles, a company spokesman said.

"We have made a consistent, longstanding effort to present pro formas as an additional analytical tool that accompanies our GAAP results," said Amazon spokesman Bill Curry. "We believe pro formas provide the best insight into the health of the business."

Facing Criticism

Pitt, a Republican, has said the SEC also may propose rules to limit companies' use of pro forma accounting. The SEC chairman, who represented large accounting firms when he was a lawyer in the private sector, is continuing the focus on pro forma accounting begun by his predecessor, Arthur Levitt.

Pitt was criticized recently by Representative John Dingell and in Washington Post and Los Angeles Times editorials for striking a conciliatory tone with accountants. The SEC chairman told Dingell, a Michigan Democrat, that Levitt's more confrontational approach "has not yielded the kinds of positive results that you and I wish for the benefit of investors."

--Neil Roland in Washington (202) 624-1868
or nroland@bloomberg.net/ba