

## **Discussion Document G – June 20, 2006**

### **Topic: Pro Forma Financial Information Required in Registration Statements upon Adoption of Statement 123(R) Using the Modified Prospective Transition Method**

Background: FASB Statement 123(R) permits companies to adopt its provisions via modified prospective application. Under this transition method, upon adoption, Statement 123(R) “applies to new awards and to awards modified, repurchased, or cancelled after the required effective date. Additionally, compensation cost for the portion of awards for which the requisite service has not been rendered that are outstanding as of the required effective date shall be recognized as the requisite service is rendered on or after the required effective date.” For periods prior to adoption, companies that accounted for employee stock options under the intrinsic value method of Opinion 25 must continue to provide the tabular presentation of the information that was required by paragraph 45 of Statement 123, which includes what is termed “pro forma” net income and earnings per share as if the fair-value-based method had been applied.

Discussion Document A from the October 29, 2001 Committee meeting indicates that pro forma financial statements prepared under Article 11 of Regulation S-X should include a pro forma adjustment to reflect an accounting change only if GAAP (i.e., APB 20 or a new accounting standard) requires the pro forma disclosure of the change. FASB Statement 154 supersedes APB 20 and does not include any requirement for pro forma information upon adoption of an accounting change.

**Question:** If a registrant that uses the modified prospective transition method provides a pro forma income statement in accordance with Article 11 for some other purpose (e.g., business combination) and that pro forma income statement covers a period prior to the adoption of Statement 123(R), should that pro forma income statement include adjustments to the historical accounting for stock options?

For example, Company X is a calendar year-end SEC registrant with publicly traded equity. Company X has an employee stock option plan which it has historically accounted for under APB 25 (with pro forma disclosures under Statement 123 included in the notes to the financial statements). Company X adopted the provisions of Statement 123(R) effective January 1, 2006 using the modified prospective transition method. Company X filed its March 31, 2006 Form 10-Q on May 1, 2006. Company X intends to file a registration statement on Form S-3 on June 25, 2006 in order to register the offer and sale by Company X (i.e., a primary offering) of its common stock. Company X acquired a significant business in mid-2005; accordingly, Company X’s Form S-3 must include (or incorporate by reference) a pro forma income statement for the year ended December 31, 2005.

**View A:** Yes. The pro forma income statement for the year ended December 31, 2005 must include the effects of the business combination and the compensation-related

adjustments under Statement 123 disclosed in the footnotes to Company X's historical financial statements.

View B: No. The pro forma income statement should not include any adjustments to the shared-based expense disclosed in the historical financial statements.

The "pro forma" disclosures required in the notes to the financial statements under Statement 123(R) do not depict what net income and earnings per share would have been had Statement 123(R) been applied during the earlier periods (i.e., there are differences between Statement 123(R) and Statement 123). Rather, the pro forma disclosures required to be included in the notes to the financial statements continue to depict the application of Statement 123 and are not required because of adoption of a new accounting standard. This would essentially depict application of the modified retrospective transition approach for pro forma purposes, even though the registrant has adopted Statement 123(R) using the modified prospective transition approach.

This conclusion is consistent with the adoption of Statement 142. The note disclosures required by paragraph 61 of Statement 142 (depicting the impact of non-amortization of goodwill and certain intangible assets) were not considered "pro forma" because they did not require the application of all aspects of Statement 142 in the earlier periods (e.g., the impairment provisions were not applied).

**Committee Recommendation:** View B

**SEC Staff Response:** The staff agrees with View B.