SEC CONSIDERING ITS OPTIONS REGARDING QUARTERLY FINANCIAL REPORTING

By Don Carpenter, MSAcc/CPA

After President Donald Trump expressed interest in eliminating quarterly reporting, the SEC requested public comment regarding the proposal. The comments or any alternatives to the current reporting requirements for public companies has not been released.

The financial markets have been criticized for having a very short-term focus and overreacting to earnings that fail to meet expectations. This short-term focus can drive managers to make decisions that mortgage long-term profitability and cash flow for immediate results. It has been proposed that replacing the quarterly reporting cycle with longer reporting periods might alleviate some of the short-term focus. Moving to longer-term reporting cycles would also bring U.S. companies into line with other world markets. The U.K. has required its registrants to report on a six-month system for quite some time, although it should be noted that a majority still opt to release quarterly results.

One obvious disadvantage of a longer reporting cycle is that investors and financial analysts have less access to financial information. A possible outcome of any reporting modifications would be an increased importance for the SEC's Form 8-K, which is required to be filed by registrants to report material events that may be important to shareholders. Form 8-Ks are generally due within four business days of a material event and are often used to report such items as acquisitions, changes in key personnel or changes in capital structure.

A company's earnings release is also an event requiring a Form 8-K. Since the promulgation of Regulation Fair Disclosure in 2000, registrants have been required to release to the public any information made available to a more limited group. This has increased the need to use Form 8-K for financial information such as investor conference or trade show presentations. Extending reporting cycles will only increase the need to monitor the flow of financial information and determine if an 8-K filing is warranted.

Countering this disadvantage are several advantages of moving to a longer reporting cycle.

1. Investors look at interim financial statements for indications of future business performance. Even small changes in margins or volumes can be cause for concern. Arguably, reporting for longer periods offers the advantage of diluting the impact of one-off or unusual business transactions. A high volume, low margin transaction will not have as material an impact on gross profit margins over a six-month period as it would for a quarter. This may allow managers more flexibility in growing business and new customer development. Likewise, seasonality will have a less pronounced effect on performance over longer periods.

2. Unusual items, such as impairments, restructurings, and gains and losses, will be less material to overall results when included in longer reporting periods. This can allow for more focus on the fundamentals of the business and less incentive for organizations to "manage" the timing and amount of such adjustments.

3. With longer interim periods, financial reporting personnel can devote more resources to management reporting and performance analysis. It is not unusual under current reporting requirements for management to require monthly financial statements to assess business performance.

This process would likely remain if interim periods are extended. However, without the demands of producing quarterly 10-Ks, resources could be re-deployed to give management more detailed and

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timely information that is relevant to operational decisions.

4. Inter-period accounting requirements for such items as period costs and income taxes can be quite complex and may yield unexpected results. Likewise, recording contingencies and revisions of accounting estimates in the proper period can be very difficult. Companies often "hold their breath" as interim reports are processed, due to the concern that such issues that did not previously meet the requirements for accrual might progress to the point that earnings should be revised, further complicating an already laborious process.

Discussions between management and the assurance team regarding what the company knew and when are very common as outside review of interim reports includes the proper timing of accruals. Eliminating quarterly reporting in favor of semiannual reports should reduce these issues.

In conjunction with the current review of interim reporting, the SEC should consider what additional disclosures investors would consider helpful. Reducing the burden of interim reporting might afford an opportunity for additional disclosures that registrants have resisted.

However, additional disclosures might also necessitate a review of the filing deadlines for annual reports. Many large filers struggle to meet the current 60-day deadline. Unless new disclosures are not sensitive to year-end financial information, eliminating interim reports may not increase the bandwidth for additional or more detailed disclosures. That may require extending the due date for Form 10-K annual reports.

Reducing the interim reporting requirements for U.S. registrants will require adjustments on the part of all parties involved in the process. Registrants would have to review and adjust workflows and staffing to effectively and efficiently utilize resources. Assurance firms would have to adjust audit programs, as interim reviews and financial information would be available less frequently. And most importantly, markets and shareholders would have to adjust their expectations for frequent financial information in a system that thrives on short-term performance.

You can read public comments on earnings releases and quarterly reports on the SEC website.