

Quarterly Reporting – What’s Next?

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Earlier this week, the SEC published a release requesting comment on the quarterly reporting system. The release is thoughtful and concise, but it mostly asks questions, so it provides little indication of what action the agency might consider taking.

Two major flaws are regularly attributed to the reporting practices of public companies: complexity and short-termism. The release engages with these criticisms, but we doubt this is the start of a process that will eventually result in significant regulatory change.

- The complexity point has been voiced repeatedly by investors and by reporting companies, although they speak from very different perspectives. It has also been taken up by Congress in the JOBS Act (2012) and the FAST Act (2015). The SEC has addressed it in a series of initiatives over the last decade, only partly at congressional direction, and these have resulted in salutary but minor tweaks to its reporting requirements.
- The short-termism point is voiced regularly by business leaders and even, on a few memorable occasions, by the President. It is a recurring theme in battles between management and activist investors, in controversies over management compensation, and in laments over the decline in IPOs and in the number of public companies.

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This week's release takes up one strand of the complexity discussion, by asking whether the quarterly reporting requirements impose unnecessary burdens on reporting companies. But, as the release points out, that question has been fully explored already, notably in connection with a 2016 concept release. The new release adds to that discussion by questioning whether redundancy between the earnings release and the 10-Q is a significant burden – although that problem, if it exists, is due to voluntary practices and not to the SEC's requirements. There is surely more the SEC could do to reduce reporting burdens, including by slimming down Form 10-Q, but complexity is deeply rooted in elements of the reporting system that the agency is unlikely to change fundamentally.

The release also takes up the tantalizing question of whether quarterly reporting is too frequent, which relates to both the burdens on companies and the specter of short-termism. It reviews regimes outside the U.S. that are more flexible, and it poses a series of questions about the implications of moving to a semi-annual reporting model. The overall impact of these questions is to demonstrate that (1) quarterly reporting to the SEC is fully built into the securities regulatory system, (2) it would be a very heavy lift to move away from it and (3) the practice of reporting every quarter is, at this point, driven as much by private ordering as by a regulatory choice.

It is hard to imagine the SEC making a big move that affects reporting frequency. Maybe it will be tempted – or pushed – to do something for small companies, because that is where the burdens are most keenly felt, but it is also where the incentives for frequent reporting and the risks of opacity are greatest.

Similarly, the release engages with the question of whether the financial reporting system contributes to short-termism, but the SEC's questions underline the reality that if short-termism is a problem, it's a matter of business strategy, not a regulatory issue. The practice of issuing earnings guidance, in particular, has many detractors, but it is also very resilient and buy-side driven, depending on the sector and the company. It is another example of private ordering in how companies communicate with the market – part of a

complex information eco-system. It is hard to imagine the SEC getting involved, whether to restrain the practice, encourage it, or regulate it.

The most novel and interesting aspect of the release concerns the practice of issuing quarterly earnings releases. This has become nearly universal, and the release walks through the sometimes difficult questions that can arise from the relationship between the earnings release and the Form 10-Q (or 10-K). But earnings releases are not a creature of SEC regulation, and current rules address them only sparingly: since the implementation of the 2002 Sarbanes-Oxley Act, the SEC (1) requires that the earnings release be furnished to the SEC on Form 8-K, and (2) regulates the use of non-GAAP measures in the earnings release.

That light touch makes sense. The earnings release system is another product of private ordering, balancing what investors want to know, what companies want them to hear, and risk considerations arising from general antifraud rules. It is not clear how or why the SEC should get further involved.

So while this week's release might be a first step toward future rulemaking, it might also be a piece of regulatory diplomacy – various observers keep saying there is a problem with the quarterly reporting process, and now the agency is asking for evidence and concrete suggestions. Unless there are actionable new ideas out there, the agency will be justified in moving on.

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