Financial Reporting ADVISORS

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VIA EMAIL TO: rule-comments@sec.gov

Mr. Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Re: File No. S7-26-18
Request for Comment on Earnings Releases and Quarterly Reports

Dear Mr. Fields:

Our firm, Financial Reporting Advisors, LLC, provides accounting and SEC reporting advisory services, litigation support services, and dispute resolution services. We specialize in applying generally accepted accounting principles to complex business transactions. We are writing to provide our comments on the Securities and Exchange Commission's *Request for Comment on Earnings Releases and Quarterly Reports* ("the Release").

We acknowledge that comments were due March 21, 2019. We had not initially intended to comment on the Release. However, having read through many of the comment letters, we would like to add our voice to the mix. We respectfully ask that our views, albeit late, be considered.

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We commend the Commission for tackling the subject of interim reporting by public companies. Good regulators periodically revisit their rules. Given that the basic quarterly reporting rules have been in place for more than 35 years, revisiting them makes sense.

There are two ways to approach the reconsideration of longstanding rules. One is to pretend they don't exist and start from scratch. The other is to assess their effectiveness and identify what, if anything, is broken. The Commission adopted the second approach. Your questions about quarterly reporting, including the practice of earnings releases and conference calls, essentially ask the following: *Is the current interim reporting framework meeting investor needs at an acceptable cost?*

The Commission's efforts in both 2008 and 2016 revealed that the answer to this question is, yes.[1] Investors typically want more information faster and issuers typically prefer less information at a slightly slower pace. But our current disclosure regime's combination of voluntary quarterly press releases and mandatory quarterly reports is achieving an acceptable balance between those competing positions.

Not surprisingly, asking the same question in the Release yields the same answers. No constituency asserts that the framework should be reworked. Investors would still prefer a little more; issuers would still prefer a bit less. The result is, again, equilibrium.

Good regulators also realize that "although all progress requires change, not all change is progress."[2] Even the smallest change comes at a cost. Thus, tinkering with something that isn't broken requires a careful assessment of whether the change is worth it.

The second question is therefore: *Are there ways to improve the cost/benefit ratio? Can we either lower costs while maintaining the same benefits or increase the benefits without a disproportionate increase in costs?*[3]

The work done by the Commission in 2008 and 2016 touched on this second question. The Release explores it in more depth by looking for ways to lower the costs of providing interim updates to investors while maintaining the same level of benefits to investors.

However, exploring this question requires establishing the baseline for what investors need. More specifically, it requires an acknowledgement that the information needed to make an investment decision is the same whether the security is being sold by the company or by another investor.

The Commission's disclosure rules governing a registration statement require the same quarterly financial statements on the same timeline as the rules governing periodic reporting.[4] In plain English, public companies are required to provide the same quarterly financial information to potential investors of newly issued securities as they do to potential investors in their listed securities.

The Release floats the possibility of a flexible interim reporting requirement or a semi-annual reporting requirement, but only for periodic reporting. It does not suggest an alternative for registration statements. How can we debate one without the other?

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[1] We are referring to the 2008 report from the SEC Advisory Committee on Improvements to Financial Reporting and the 2016 SEC Concept Release No. 33-10064; 34-77599, *Business and Financial Disclosure Required by Regulation S-K.*

[2] This saying is attributed to John Wooden.

[3] Lowering both the costs and the benefits proportionately is change without progress.

[4] The rules on "age of financial statements" in a registration statement require issuers to provide quarterly information on the same timeline as the periodic reporting requirements for Form 10-Q.

More importantly, why would the Commission consider a disclosure regime that allows companies to provide investors with information less frequently?

US investors have been requesting—and listed companies have been providing—quarterly information since the 1920's, decades before the SEC instituted its periodic quarterly reporting rules. The New York Stock Exchange added quarterly reporting to its listing requirements in 1939. The American Stock Exchange followed suit in 1962. The demand for quarterly information by US capital markets has been a constant for nearly a century.

Similarly, benchmarking our periodic reporting model against those of other countries requires knowing the baseline information requirements in those countries. Their disclosure frameworks may not require quarterly financial information in a prospectus or registration statement. Half-yearly information supplemented by discrete information about material subsequent events may be deemed sufficient in other jurisdictions. Countries with that disclosure framework face a very different cost/benefit judgment when debating a quarterly reporting regime.

If the Commission's goal is to reduce costs while maintaining the same benefits to investors, then the focus should be on the quarterly reporting task that is most costly. It isn't closing the books or preparing summary financial information or developing updated forecasts for the year. It isn't insuring compliance with debt covenants or evaluating contingencies. It isn't discussing or analyzing results. Those are routine tasks for any business.

We believe that for most companies, the single largest quarterly reporting cost is the preparation of US GAAP compliant interim financial statements. To reduce the cost of interim reporting in any meaningful way, we need to make meaningful changes to the accounting model for interim reporting.

The SEC's regulatory framework views quarterly information as integral to the annual results. The rules state that only major captions need to be provided. There's a bright-line materiality rule that can be used to combine captions. Companies are told to presume that investors have read the most recent annual financial statements and to determine the adequacy of additional disclosure in that context. If the information disclosed at year-end has not changed significantly, it need not be repeated with one exception: material contingencies must be disclosed even if there has been no change.

We agree with the Commission's framework for quarterly information. We do not believe interim reports should be considered standalone reports. Interim reports are just that—periodic updates that summarize activities and highlight developments since the last comprehensive report. But, like others in our profession, we are bound by the standards in US GAAP.

The FASB is responsible for establishing US GAAP. Its current agenda includes a project on interim disclosures. If the FASB were to adopt standards for interim financial reporting that are fully consistent with the SEC's framework, change would likely be accompanied by progress.[5] If not, it

[5] In 2014, FASB preliminarily decided that disclosures should be made in an interim report if there is a substantial likelihood that the updated information would be viewed by a reasonable investor as significantly altering the total mix of information. To date, no further decisions have been made. The FASB's most recent discussion of this project, in July 2018, ended with a request that the FASB staff develop principles for interim disclosure and perform more research and outreach.

is difficult to see how the Commission can change its rules to meaningfully reduce the cost of interim reporting without also significantly reducing the information provided to investors. If the Commission were to eliminate the requirement to present US GAAP financial statements in interim reports or permit semi-annual reporting in both registration statements and periodic reports, the result would be an extreme retrogression in disclosures.

As to the question of short-termism, US listed companies have been providing investors with selected quarterly information since the 1920's. They have been filing Form 10-Qs since 1970. The theory that reporting information every quarter is just now causing companies to manage for the short-term is not credible. Further, unless internal reporting is also prohibited, management will remain keenly focused on achieving quarterly (or even monthly) metrics so long as they are held accountable for them.

To the extent it exists, short-termism is not caused by quarterly reporting to shareholders or by quarterly disclosures of earnings guidance. If management is myopically focused on the near-term and making decisions that are inconsistent with the company's long-term strategies for growth and profitability, the issue is one of governance.

Short-termism is the inevitable by-product of earnings targets that are based on short-term thinking. The root cause is the earnings target itself, not the disclosure of it. Said another way, if the quarterly earnings target is based on actions, projects and goals that are integral to the execution of the company's longer-term strategy, then focusing on achieving the quarterly target is not myopic: it's strategic.

Thank you for your consideration. If we can answer any questions, please do not hesitate to contact us.

Sincerely,

Financial Reporting Advisors, LLC

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