COMMUNICATION OF CORPORATE INFORMATION

An Address by Harold M. Williams, Chairman
Securities and Exchange Commission

Financial Executives Institute/
National Investor Relations
Institute
Chicago, Illinois
March 15, 1979
It is a pleasure to have the opportunity to address the Financial Executives Institute and the National Investor Relations Institute once again. Your two groups and the Commission enjoy a kind of symbiotic relationship. The Commission's primary reason for being is corporate disclosure, and your organizations are two of the key private sector groups concerned with that issue. In large measure, what you do not accomplish through your day-to-day efforts, we endeavor to accomplish through regulation. For that reason, when I spoke at the FEI International Convention last October, I emphasized the vital role of corporate financial executives in shaping progress in financial reporting, both through individual corporate activities and through the FEI.

In that vein, I would like tonight to outline for you my thoughts on the future direction of the subject with which we are all vitally concerned -- the communication of corporate information. In my view, the communication process has become fragmented. And, if that is indeed the case, the responsibility for the resulting dilution in the usefulness to investors of corporate information must be laid at both the Commission's door and that of the private sector. The solution lies in reuniting and integrating the
now separate pieces of the corporate communication system, and that is a process which will require our cooperative efforts.

This evening I want to describe how the federal securities laws and other factors have contributed to a compartmentalization in corporate communication and how we should begin to correct that process by redefining the corporate responsibility for providing investors with useful information so that the Commission's regulatory role and burden can be minimized. This approach will work only if companies recognize that they have the primary responsibility for providing disclosure, and, if given the flexibility, will exercise their obligations responsibly. The Commission, in turn, must begin to explore its disclosure requirements to assure that they place upon companies both the burden and opportunity to meet their responsibilities in a meaningful fashion. I hope this evening to begin the dialogue by which that process can come to fruition.

I. The Fragments of Disclosure

I spoke a moment ago about fragmentation and compartmentalization in corporate communication. Let me begin by explaining what I mean by these terms.
In 1933, Congress made a fundamental decision which permanently reshaped the manner in which American corporations raise capital. In enacting the Securities Act of 1933, and the subsequent components of the federal securities laws, Congress determined that the goals of protecting investors and fostering trust and confidence in our capital markets could best be attained through disclosure, rather than substantive regulation of securities offerings. For that reason, the federal securities laws require that certain information be filed with the Commission, both before securities are initially sold to the public and on an on-going basis thereafter.

Over the years, the Commission has become increasingly sophisticated in articulating the types of information useful to investors and, correspondingly, increasingly prescriptive in requiring disclosure. While regulators may have -- as some would argue -- an inherent tendency to make the most of their regulatory mandates, the public corporations under our jurisdiction must bear a large share of the responsibility for this trend. They have placed considerable pressure on the Commission for greater
certainty -- and thus more detailed rulemaking with respect to disclosure. And, too often, when the Commission or the accounting profession has offered flexibility and called upon corporate management to use its own judgment in making disclosure, helpful and meaningful disclosure has not been forthcoming. As a result, we have had to respond with progressively more rigid and detailed disclosure requirements.

The resulting constellation of forms and reports has been the subject of criticism on several counts. In the view of many commentators, some -- perhaps many -- of the Commission's requirements yield information at best irrelevant to investment decision making and at worst so costly that its benefits to a limited class of sophisticated investors are far outweighed. While there is, I believe, much to be said on the other side of the argument, it is difficult to dispute that many investors -- the presumed beneficiaries of our disclosure scheme -- regard the information they receive from corporations as cumbersome, complex, and often unusable.

Partially in response to such criticism, the Commission chartered, in 1974, an Advisory Committee on Corporate Disclosure. One aim of the Committee was to
articulate the objectives of a system of corporate
disclosure and to measure the Commission's present
disclosure policies against those objectives. That
Committee concluded, based on sample responses from
publicly-held companies and the views of other commenta-
tors, that dissemination of 1934 Act reports --
particularly the familiar 10-K -- beyond the required
distribution is infrequent and seldom at the request of
shareholders -- although many 10-K users get copies in
other ways, and my information is that demand for the 10-Ks
is growing, perhaps as part of the tender offer growth.
In short, although the Committee concluded that our
disclosure system is sound and does not need radical reform,
many view the Commission's disclosure system as engendering
little more than a dialogue between reporting companies and
the Commission. Investors especially those without
sophisticated analytical tools, seek their information
elsewhere or do without.

At the same time, however, a separate information
channel has grown and flourished alongside the Commission's
formal disclosure requirements. For many investors, the
most important, timely, frequently-used and widely-
disseminated information sources are company press
releases and annual and quarterly reports to shareholders. For example, those investors surveyed by the staff of the Advisory Committee generally indicated that the company annual report to shareholders -- not the 10-K, but the glossy document with the pictures -- was their chief source of information. In fact, over 91 percent of the responding investors reported that they had read the annual report. Although I do not have the comparable figure for the 10-K, I would estimate its readership at less than 10 percent. While that less than 10 percent may be the most significant and influential in terms of market impact, the implications of the disparity in readership between the two documents deserve serious consideration.

Similarly, press releases -- and the resulting reports in the financial and popular press -- are acknowledged as the most direct medium for prompt disclosure of the full variety of company activities. In practical terms, these documents provide the essential, timely information upon which investment and other decisions are based.

The less formal system of corporate communication, however, has not gone without its share of criticism. The research of the Advisory Committee indicated that the press and other information disseminators viewed press releases with some skepticism, suggesting, among other things, that
the releases are frequently inadequate, that earnings releases in particular are presented only in the most favorable light, and that the releases often do not contain adequate substantive information about the company's operations. For example, one point which I have addressed in several speeches is the tendency to focus on earnings per share, as a precise measure of corporate and management success with only vague inference to what is behind that number.

Similarly, annual reports often appear to reflect the results of a conflict between the desire to create a promotional document and the need to provide full and fair disclosure. Meaningful disclosure frequently loses. In that sense, the attractive but somewhat vacuous shareholders' report is the other end of the continuum which begins with the 10-K.

Joel Stern in a recent article in the Wall Street Journal put it well when he said that one of the reasons a company's stock often does not sell at what its management believes to be fair value is the low quality of financial information management, in general, provides investors. He went on to say that

Instead of discussing the company's prospects and risks in the annual report's letter to the shareholders, most chief
executives squander their opportunities for effective disclosure by employing traditional procedures that emphasize historical results, with the emphasis on earnings per share. The slick brochure format usually presents last year's results, perhaps an historical accounting review covering five or 10 years and occasionally a statement on passive, shapeless qualitative aspirations.

Investors need and want a statement of corporate objectives and financial policies that describe where the company is heading and how it hopes to get there. Share prices reflect all relevant available information. The point here is that information available to management may not be available to the investing public. If it is, tomorrow's higher share price can often be achieved today.

Conversely, I suspect that some corporations fear that tomorrow's lower share price might be achieved today.

In addition to the dichotomy between required and informal disclosure, the fragmentation of corporate reporting has a second dimension. There has been an unfortunate tendency in the past to distinguish between information within the financial statements and financial information outside the financial statements. A by-product of this is that the focus of financial disclosure has been much too heavily on accounting questions within the context of traditional financial statements, and the approach has tended to "all or
nothing." That is, information not perceived as being part of historical cost financial statements has frequently been regarded as wholly outside the discipline of accounting and of financial reporting. And, correspondingly, disclosures which users have demanded and which are "financial" in nature -- such as segment information and geographic operating data -- have been forced into the mold of the financial statement, even where the information involved does not fall squarely within traditional financial statement concepts. This type of debate -- while fascinating to accountants, academics, and government regulators -- is essentially unproductive from the investor's standpoint, except in those situations, such as inflation accounting and accounting for oil and gas activities, where the essential information has been provided in neither the financial statements nor as supplemental financial information.

II. Reuniting the Components of Disclosure

In my view, both investors and reporting companies would benefit from a more coherent and less fragmented disclosure. Our objective should be an integrated system, which provides timely, adequate, and comprehensible public disclosure of material information on public companies to users. We must increase the utility of Commission-mandated
disclosure to investors by providing more concise and comprehensible information, and, at the same time, increase the utility of the data otherwise provided by the corporate community.

In order to reach this objective, the Commission, the companies, and the accounting profession must examine their approach to disclosure and consider modifications. Companies must assume a greater responsibility for company specific information and exert greater discipline with respect to direct communications to users. At the same time, the Commission must be less precise in its requirements and provide for greater integration with direct communications and between 1933 Act registration statements and 1934 Act reports. The accounting profession, for its part, must recognize that the expectations and needs of users require it to assume responsibilities for a wider range of financial information.

A. Corporate Actions

I want first to turn to the corporate role. I sense, and the Financial Analysts Federation reports, an increased willingness on the part of many companies to provide information beyond that specifically required by law. I
also sense an increase in candor in written and oral communications, including a willingness to describe unfavorable developments without the gloss of optimism that so often characterizes corporate communications. I believe it reflects a sincere desire on the part of some companies to improve their credibility with investors and other users of financial information.

The willingness on the part of companies to provide information beyond that specifically required by law is essential, because the Commission's mandated disclosure system, no matter how improved cannot specify what each company should appropriately provide under its specific circumstances. Responding to Commission requirements often is merely a mechanical way of assuring that disclosure has, in fact, occurred, but it does not necessarily discharge the obligation of timely, adequate and comprehensible disclosure to shareholders and other users of financial information.

I would now like to discuss some of the areas in which management can take steps to improve both the flow and substance of financial information to users.

The earnings announcements appearing in the financial press are often the first indication that investors and other
users receive of a company's current operating performance. The earnings announcement is thus a vital communication vehicle between the corporation and the investor. Yet, as I mentioned earlier, the Advisory Committee's Report indicated that the financial media view many press releases as primarily public relations pieces. Earnings releases, for example, tend to present those numbers which portray the company in its best light at that time -- and frequently only those numbers. Moreover, many felt that the mere presentation of numbers was inadequate; management should be obliged to discuss the implications of the numbers on a realistic basis. Some also believed that earnings releases should contain additional information that would assist readers in understanding how the earnings figures related to the company's operations.

Corporate managements should carefully consider these criticisms. It should not be the responsibility of the Commission to specify the types of additional data or explanations which should be included in earnings announcements. Management is in the best position to be aware of the significant factors affecting a company's reported operating results. Thus, it is as much a management responsibility to determine the informational
content of its press releases as it is to provide informative narrative explanations of a company's financial results in the management discussion and analysis of the summary of operations in the annual report. The importance of managements carefully fulfilling this responsibility is confirmed by a recent study in which 73 percent of the editors in the survey had as their first preference inclusion of management discussion and analysis of its business in its earnings releases on a regular basis. *

Managements should review their procedures for preparing press releases -- in particular, earnings announcements -- to ensure that they contain sufficient narrative explanations and information which will be useful to investors and other users in evaluating the quality and trend of a company's reported results of operations. I recognize that increased management efforts in response to these concerns may not result in the publication of all the appropriate information in the

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*/ Ketchum, MacLeod & Grove, Inc., Corporate Reporting as Economic Education, "A Study of Business Media and Corporate Public Relations Executive Attitudes" (1976).
financial press. However, improvements in the quality of company-prepared press releases, over time, will result in an improvement in the information reported by the financial press, and can be carried over to improve the quality of the disclosure provided to shareholders in quarterly reports.

Another area where management should assume greater responsibility and take the initiative for increased disclosure is in the annual report. As the Advisory Committee on Corporate Disclosure found in its study, the management analysis is regarded by many investors and analysts as one of the best disclosure concepts ever adopted by the Commission. Yet, the Committee noted that in many cases the discussion has not been meaningful, in part, perhaps, because the numeric materiality standards included in the guides encourage mechanical compliance. The discussion that the discussion of operations is often poor, bland, and tells little if anything about important developments. It also often does little to reflect the special character of the company. In many instances, the analysis does nothing more than repeat numbers located elsewhere in the report rather than providing an analytical discussion of why major shifts in earnings or balance items have occurred.
The management discussion does give the company an unusual opportunity, which many are not taking advantage of, to articulate the company's objectives and financial policies; to describe where the company is headed and how it hopes to get there; and to establish and maintain credibility. Included in the management discussion should be factors about the particular business which managements are in the best position to know. For each business, there is a limited set of critical variables which presents the pulse of the business. This is the information that shareholders and other users want to know and will try to figure out if not told. Management is in the best position to know what it is about its company that is important to the users of its reports and need not await the development of industry guidelines by the Commission.

While the Commission must share the responsibility for disclosure requirements which result in boiler plate, issuers must realize that they cannot satisfy their disclosure obligations simply by viewing the Commission's disclosure requirements as a checklist. Another rejoinder I hear often is one of concern about the risk of competitive disclosure. More often than not, however, the real reason is the desire to obscure poor performance or at least to avoid the
precedent which might make it necessary to talk about poor performance in the future. And yet, poor performance is not secret, or at least it does not remain so for very long, and a lack of candor catches up with the company quite rapidly.

There are many other areas where management has the opportunity to take the lead in improving disclosure. First, the flow of funds statement is becoming increasingly important to shareholders, and companies should consider enhanced disclosure. To an increasing number of investors and other users, it is the most informative statement.

Second, more adequate information should be provided with respect to pension fund accounting -- disclosure of pension fund liability is inadequate today. The FASB has this matter under consideration, but there is no reason why companies cannot do a better job of reporting now. A recent report by the Corporate Information Committee of the Financial Analysts Federation expresses the opinion that accounting for pension fund liabilities may be the last area of corporate reporting that is conspicuously deficient. I agree that is "conspicuously deficient," but not that it is the "last area." The Committee suggest the following items of disclosure: year's pension expense, value of pension
fund assets (at market value for common stocks and equivalents), unfunded prior service costs, vested benefits, composition of pension fund assets, interest assumption, and wage assumption. They also note that companies are expanding the amount of information they are releasing voluntarily.

A moment ago I commented that pension fund accounting was not the last area of deficiency. In my judgment, the failure of corporate reporting to provide adequate information about the impact of inflation and changing prices on corporate performance -- present and future -- is the most serious deficiency.

By reporting only on the basis of assumptions as to values and costs which are no longer economically valid, the reports provide inadequate and even misleading information as to earnings, costs, adequacy of capital reinvestment, etc., which seriously distort not only private decision-making but public policy as well -- including tax policy and anti-inflation policy.

Finally, as to corporate reporting, I trust that the FEI Committee on Corporate Reporting guidelines for the preparation of a statement of management responsibility for financial statements will be broadly and thoughtfully
implemented -- not as additional boiler plate, but tailored to the circumstance of the individual company.

B. Commission Requirements

While the onus is chiefly on corporate reporting, I do not mean to suggest that the Commission has no role to play in improving disclosure. Not only must we pursue our commitment for integration of 1933 Act registration statements and 1934 Act reports and for greater emphasis on review of 1934 Act reports, but we also must take a fundamental look at our disclosure requirements to ensure that we are providing companies with the opportunity and obligation to assume greater responsibility for the timely and adequate disclosure appropriate to that company, rather than responding mechanically.

The Commission's Advisory Committee on Corporate Disclosure recommended, among other things, a revision in the Commission's Form 10-K to make it a more flexible document. As many of you know, the Committee's revised form reduces the required disclosure to nine major categories of information in five sections that would group data so that the users could refer directly to information of particular interest. In addition, the revised form incorporates the concept of a terse fact sheet
that would succinctly present capsule financial data, a brief business description, and certain other factual information, rather than the lengthy narrative disclosure under current practice.

The Commission published for comment, in August of last year, the Advisory Committee's revised form, and, in addition, requested comment on Part I of the Form 10-K presently required to be filed by most public companies. The staff is in the process of completing its review of the comments received on this proposed substantial revision of the Form, and expects to move quickly on this project.

The increased flexibility and deletion of unnecessary reporting requirements in the Advisory Committee's Form 10-K, if adopted, could provide more incentive for integrating the Form 10-K and annual report to shareholders. As many of you are aware, in 1977, the Commission published Guide 4 under the 1934 Act which permits such integration. Nevertheless, few companies saw this as an opportunity. I hope that whatever action we take on our Form 10-K project will encourage companies to consider comprehensible annual and quarterly report forms that can satisfy the information needs of users and our reporting requirements.
Another opportunity for more meaningful disclosure by corporations is in the area of projections of future performance and financial condition, as well as management's plans and objectives. In view of the importance attached to forward-looking information and the prevalence of projections in the corporate community, the Commission in November 1978, took initial steps to encourage the voluntary disclosure of this information. Historically, the Commission had permitted disclosure of essentially objectively-verifiable historical facts -- "hard" information -- as distinguished from opinions, predictions, analyses, and other subjective information -- "soft" information. In recent times, the Commission has departed from this position and our November actions demonstrate a commitment to actively encourage this type of information.

First, the Commission issued a statement encouraging companies voluntarily to disclose management projections and published staff guides for such disclosure. Second, the Commission proposed for comment a safe harbor rule designed to afford protection from the liability provisions of the federal securities laws for reasonably-based projections, both in Commission filings and otherwise, disclosed in good faith, that are subsequently proven erroneous -- as many inevitably will.
The staff has reviewed the many thoughtful comments received in response to this proposal and is considering means of expanding the proposed rule consistent with investor protection.

The Commission is also taking further steps to integrate the disclosure requirements for 1933 Act registration statements with those for 1934 Act reports. These efforts are intended to eliminate duplicative disclosure, and thereby reduce the cost burden to registrants while assuring that basic information for investment decision making is furnished without repeating other information that already has been disclosed and generally is available.

Within the past year, the short registration Form S-16, which incorporates by reference all current 1934 Act reports on file that already contain basic firm-oriented information, has been expanded in a number of respects. Primary underwritten offerings are now permitted on this form by certain high-quality issuers and their subsidiaries, as well as rights offerings and offerings of securities pursuant to dividend and interest reinvestment plans. The staff will be exploring other ways to broaden the categories of issuers and transactions,
who can avail themselves of this concept, as further experience with it is gained.

The staff of the Division of Corporation Finance, the division primarily responsible for the administration of the disclosure provisions of the federal securities laws, is committed to the development of an integrated disclosure system of the type I have just described. The Division's very able and competent staff, under the leadership of Ed Greene, newly appointed as director, is prepared to work with issuers and their counsel to develop more meaningful approaches to the communication of corporate information.

C. The Accounting Profession

I want to add just a few words about the accounting profession's, particularly the FASB's, role in this process.

The FASB's most recent statement on its conceptual framework project, which spells out the Board's view of the scope of financial reporting objectives, is an important step in integrating the disclosure system, because the Board has not limited its scope to financial statements, but rather has elected to define its task in terms of financial reporting in general. Just as significantly, the statement reflects the philosophy that financial information is not simply a record of past occurrences, but is equally of value
in enabling users to assess the future. Moreover, the focus of the statement on users of financial information, as opposed to solely investors, is an important recognition of the broader scope of the constituency using financial information.

The FASB also is taking other important steps, such as in the area of interim reporting, where further definition of applicable accounting principles and practices is essential.

As we move toward integration of our disclosure system, the role of the independent auditor will grow, and, increasingly, focus will have to be directed to auditor association, on a timely basis, with all financial information generally disclosed by a company.

III. Conclusion

I am confident that, through increased corporate responsibility for disclosure -- and more Commission sensitivity in response -- we can meet the objective of integrating the corporate communication system. The integrated disclosure system will bring together the disclosure provided through direct communications with shareholders and Commission requirements into a single comprehensive system, which will provide, on a timely and continuous basis, reliable information material to
informed decision-making. It also will further integrate 1933 Act registration statements and 1934 Act reports and de-emphasize the distinction that has grown up between financial statements and other financial information.

I have explained this evening why I believe that this integrated disclosure system can be of significant benefit to public companies, as well as to investors and other users of financial information. To the extent that companies are willing to take the initiative in communicating timely and adequately with their shareholders, the Commission can play a less visible and prescriptive role than it has in the past. In that sense, the FEI, and NIRI, in conjunction with the organized accounting profession, hold the key to the future direction of financial reporting.

Thank you.