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Office of the Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

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

Dear Office of the Secretary:

Crowe LLP appreciates the opportunity to provide input on the Securities and Exchange Commission ("SEC") Request for Comment, "*Earnings Release and Quarterly Reports*" ("Request"). We support the SEC's efforts to explore avenues to reduce the administrative burden on reporting companies while at the same time seeking to maintain or enhance investor protection.

Crowe is inspected annually by the Public Company Accounting Oversight Board ("PCAOB") as we audit more than 100 issuers, as defined in the Sarbanes-Oxley Act of 2002. SEC rules¹ require that we perform quarterly reviews² of issuers' interim financial statements prior to the inclusion of these financial statements in quarterly reports on Form 10-Q. Issuers might also request that we provide them with comments on their draft earnings release prior to furnishing the earnings release in a Form 8-K. It is from this perspective that we provide our commentary.

Auditor Involvement in Form 10-Q Enhances the Reliability of Data

We agree with SEC Chief Accountant Wes Bricker's statement in his speech at the 2017 Baruch College Financial Reporting Conference that "high-quality information leads to better decisions for participants in our capital markets."³ The SEC's current requirement for auditors to perform a review, under applicable professional standards, of issuers' interim financial statements prior to their inclusion in Form 10-Q has a significant impact on the quality and reliability of the information that is filed.

When the SEC first required auditors to perform interim reviews of financial statements filed on Form 10-Q in 1999 ("1999 Release"), it noted:

We believe that the reviews required will facilitate early identification and resolution of material accounting and reporting issues because the auditors will be involved earlier in the year. Early involvement of the auditors should reduce the likelihood of restatements or other year-end adjustments and *enhance the reliability of financial information [emphasis added]*.⁴

¹ Article 10-01(d) of Regulation S-X

² PCAOB Auditing Standard 4105, *Reviews of Interim Financial Information* (AS 4105)

³ <https://www.sec.gov/news/speech/remarks-2017-baruch-college-financial-reporting-conference-advancing-our-capital>

⁴ 64 FR 73392

Recent SEC enforcement action and related communications reinforce this conclusion. For example, in a September 2018 press release,⁵ the Division of Enforcement announced “data-driven investigative techniques led us to identify [five] companies, who had deprived investors of the benefit of the external auditor’s involvement by including financial statements in Forms 10-Q that had not been reviewed in accordance with Regulation S-X.” The press release also notes that the interim review requirement “helps to ensure that investors are provided timely, accurate, and reliable interim financial information on a periodic basis.” Each of the five companies listed in the press release filed between one and three Forms 10-Q that did not comply with the interim review requirement, and four companies restated at least one of their unreviewed Forms 10-Q when the auditor completed their interim review and the issuer amended its filing.⁶ This data demonstrates the auditor interim review requirement improves the quality and reliability of information included in interim financial statements, which is key to our capital markets.

As noted in the 1999 Release, auditor involvement earlier in the year results in better financial reporting outcomes. While not required at interim reporting dates, auditors might at times elect to perform audit level procedures on certain transactions or classes of transactions (for example, the adoption of accounting standards in an interim period when that accounting standard is expected to have a material or pervasive impact to the issuer or other material transactions occurring during an interim period). Performing audit procedures related to certain transactions or classes of transactions at interim dates serves to spread the timing of audit procedures and increase the efficiency of audits, but for the most part, such procedures do not result in significant incremental costs. For example, at the largest companies, auditors might perform year round audit procedures, which might cover some material transactions but not all in any given quarter. Moreover, in many cases, interim review procedures are a discrete activity, scheduled to occur at required interim dates, because performing year round audit procedures at many entities would not be an efficient way to perform the audit. In those cases, any audit procedures performed at an interim reporting date merely changes the timing rather than the extent of the procedures required to be performed for purposes of the annual audit. While audit procedures are neither required nor expected by stakeholders at interim reporting dates, a tangential benefit of performing some audit procedures at interim dates is that data reliability is further enhanced beyond the assurance provided by interim reviews.

We acknowledge that the interim review requirement results in auditors incurring incremental time that would not be spent if an interim review requirement did not exist. However, it is not clear whether such incremental time results in any net increase in cost to issuers, in particular because there is evidence to suggest increased reliability of data results in decreased costs of capital. The Enforcement example above suggests that lack of an interim review can lead to restatements, and in a 2003 paper, the authors concluded entities’ cost of capital increased immediately after a restatement because the restatement lowered perceived earnings quality and increased users required rates of return⁷ (that is, to compensate for the risk of unreliable data). Wes Bricker also noted in a 2017 speech that “lower-quality financial reporting [can lead to]...higher financial reporting restatement rates and higher cost of capital.”⁸ Clearly, the data reliability provided by auditor interim reviews provides benefits to the investor and to capital formation.

Auditor Involvement in Earnings Releases

The Request indicates “federal securities laws do not require reporting companies to publish earnings releases, conduct earnings calls with investors and analysts, or issue forward-looking earnings guidance.” In addition, the Request notes that the timing of earnings releases in relation to the filing of Form 10-Q varies by issuer. Some issuers release earnings well in advance of filing a Form 10-Q and others publish their earnings release concurrently with their filing on Form 10-Q.

⁵ <https://www.sec.gov/news/press-release/2018-207>

⁶ The fifth company never amended its deficient filings, and it subsequently terminated its registration.

⁷ Hribar, Paul and Jenkins, Nicole Thorne, The Effect of Accounting Restatements on Earnings Revisions and the Estimated Cost of Capital (November 2003) at <https://ssrn.com/abstract=488003>

⁸ <https://www.sec.gov/news/speech/bricker-remarks-annual-life-sciences-accounting-and-reporting-congress-032117>

Neither SEC rules nor professional standards require auditors to perform any procedures on information included in earnings releases. However, in many circumstances, issuers request that auditors provide comments on the content of their earnings release prior to furnishing it in Form 8-K. Issuers have wide latitude in the form and content of the information presented in their earnings release, subject to rules related to the presentation of certain financial measures (that is, non-GAAP measures).⁹ In our experience, due to the wide latitude in form and content, many of our substantive historical comments on earnings releases are related to items such as non-GAAP measures. Due to the limited, if any, role of the auditor, earnings releases do not benefit from the data reliability provided by interim reviews.

Timing of Form 10-Q versus Earnings Releases

Due in part to the flexibility issuers have on whether to issue and what to include in an earnings release, we experience a wide range of issuer expectations with respect to the status of our interim review procedures at the time the earnings release is filed. Some issuers prefer that we are substantially complete with our interim review procedures prior to releasing earnings, and other issuers might release earnings while we are still performing our procedures. On a much more limited basis, some issuers do not request our review of their earnings release prior to furnishing it in Form 8-K. In many cases, we observe that the issuer's perceived risk of changes or subsequent events between the release of earnings and the Form 10-Q filing influences the proximity with which each are filed.

Typically, the completion of our interim review procedures on the interim financial statements included in Form 10-Q follows management's timeline and process (that is, we perform our procedures as soon as practicable after management has prepared the requisite information and operated their internal controls over financial reporting). Because our review procedures closely mirror management's timeline, we believe the requirement to complete an interim review prior to filing Form 10-Q does not contribute to any meaningful delay between publication of an earnings release and the filing of a Form 10-Q because, generally, the availability of information from the issuer drives the timing and completion of our interim review procedures.

Use of Form 10-Q to supplement Form 8-K Earnings Releases

The Request puts forth a potential change in interim reporting whereby issuers could use information presented in their Form 8-K as the basis for their required disclosure and then supplement the Form 8-K with additional material information filed in Form 10-Q or alternatively incorporate by reference disclosure from the Form 8-K earnings release into its Form 10-Q (the "Supplemental Approach"). We have concerns such an approach will have certain unintended consequences.

If the SEC adopts the Supplemental Approach, a number of questions might arise from the perspective of users, preparers, auditors, and other stakeholders with respect to how and when interim review procedures would be performed and how to interpret the reliability of data in the earnings release to the extent it precedes the filing of the Form 10-Q.

Consider a fact pattern under the Supplemental Approach where an issuer includes a full set of basic financial statements in its earnings release. Under current professional standards,¹⁰ auditors would not be required to perform any procedures with respect to such information. Users, however, might assume that review procedures had been performed at the time the earnings release is furnished under the Supplemental Approach, which could create investor confusion.

Likewise, preparers and those charged with governance, including audit committees, might struggle with understanding the level of required auditor involvement at the time the earnings release is furnished under the Supplemental Approach when information is to be incorporated by reference into a later filed 10-Q.

⁹ See, for example, Item 10(e) of Regulation S-K.

¹⁰ *Supra* Note 2.

Investors and those charged with governance might assume that any financial information incorporated by reference into a Form 10-Q to be filed in the future would be reviewed at the time the information first appears in an EDGAR filed document. To the extent the SEC concludes the Supplemental Approach is an appropriate path forward, it would be critical for the Commission to clarify what level of auditor involvement would be required when the earnings release is furnished versus when the Form 10-Q is filed, particularly if information furnished in the earnings release is allowed to be incorporated by reference into a Form 10-Q filed in the future.

The SEC might also need to consider changes to Form 8-K and Articles 8 and 10 of Regulation S-X ("Articles 8 and 10") under the Supplemental Approach to insure that data comparability between issuers is achieved. Auditors currently perform review procedures over interim financial statements in Form 10-Q for all domestic issuers. U.S. generally accepted accounting principles and Articles 8 and 10 provide a framework for the form and content of interim financial information and fosters comparability between issuers. Given the lack of form and content requirements for earnings releases, an unintended consequence of shifting to a Supplemental Approach could be a significant decrease in comparability between issuers. To the extent the Supplemental Approach requires an auditor to perform review procedures at the time the earnings release is furnished, we believe lack of comparability will create challenges to our ability to complete required interim reviews under current professional standards.¹¹

In addition, PCAOB standards might need to be revised to address both the timing of review procedures as well as to understand how subsequent events would be addressed in the Supplemental Approach. Any SEC rule and PCAOB standard changes would need to address if review procedures would be required both prior to inclusion of interim financial information in earnings releases on Form 8-K as well as when additional material information arises that impacts any supplemental disclosure filed in Form 10-Q. We encourage the SEC to work with the PCAOB in making any necessary changes to professional standards if the Supplemental Approach is adopted.

Short-Termism

The Request notes that there are differing views about whether current quarterly reporting practices result in what the Request defines as "short-termism," which is generally focused on whether practices related to quarterly earnings guidance result in an undue focus on short-term results (for example, meeting or falling short of previously announced guidance).

It is difficult to assume all users and other stakeholders have the same views with respect to whether quarterly earnings guidance is useful or detrimental to investment decisions. Certain users might value earnings guidance in their investment strategies, which might differ from investors who favor a longer-term investment approach. We suggest the SEC consider feedback from the Request and consider whether it would be appropriate to undertake further targeted outreach with users and other stakeholders to determine if quarterly earnings guidance is useful or detrimental to investment decisions. Further, the SEC should consider feedback from investors about whether curtailing available information might impact certain trading strategies and the depth and breadth of the markets as a whole.

Changes in Reporting Frequency

The Request poses questions regarding whether the SEC should adopt a voluntary or mandatory semi-annual reporting model for all or certain categories of reporting companies or whether such a model should apply to certain industries or certain classes of issuers. The SEC's current regulatory reporting regime is based in part on categories of reporting companies (for example, smaller reporting companies, non-accelerated filers, emerging growth companies), and the model provides certain disclosure and other accommodations for each of the various categories. However, while the current reporting model for

¹¹ Supra Note 2.

domestic registrants provides some timing accommodations to certain categories of issuers,¹² the model does not provide any accommodations with respect to frequency of reporting. Harmonization of reporting frequency across all categories of issuers is important to insure the availability of information is not impacted by issuer size or industry.

Information availability and the reliability of that information is key to effective investment decisions, and it is unclear what benefits, other than potentially reduced administrative burdens, would accrue to issuers if the current reporting model were changed to require or provide an option for semi-annual reporting. The frequency of reporting and the related rigor around preparing disclosure documents, operating internal controls over financial reporting, and having an auditor perform review procedures necessarily has a positive impact on the reliability of the data, which, as noted above, has a positive impact on cost of capital. Further, a 2012 paper¹³ that examined the relationship of the cost of capital over a 20 year period for SEC registrants, based on the frequency of reporting, concluded public companies in the U.S. that either voluntarily or were required to increase their reporting frequency had a decrease in their cost of capital.

Issuers, absent any changes to Form 8-K, would still be required to report material events and make disclosure pursuant to Regulation FD even if the SEC changes the required interim reporting frequency. With certain exceptions,¹⁴ information presented in Form 8-K is not required to be reviewed or audited at the time the 8-K is filed. More frequent interim reporting allows users and other stakeholders to benefit from auditor involvement in such information more quickly, which has multiple previously noted benefits.

Finally, certain industries (for example, insured depository institutions) might have other regulatory requirements to prepare and file quarterly financial statements or similar information. We question whether entities in those industries would achieve any meaningful reduced administrative burden if the SEC changes required interim reporting intervals.

Preparers are in the best position to quantify the impact of any potential reduction in administrative burden, so we suggest the SEC obtain sufficient feedback from preparers to understand whether any reductions in administrative burdens would outweigh the clear benefits of more frequent reporting.

Other Considerations

Efficiency of Capital Formation

When raising capital in either the public markets or pursuant to an exemption from registration, issuers hire underwriters who often request the auditor provide a comfort letter prior to any offer or sale of securities. Current professional standards¹⁵ only allow auditors to provide negative assurance to underwriters as to subsequent changes in specified financial statement items as of a date less than 135 days from the end of the most recent period for which the auditor has performed an audit or a review.

A change in reporting frequency (for example, to semi-annual reporting) would not impact our ability to provide comfort under the standard if we were separately engaged to perform an interim review over an appropriate period. Rather, a change to semi-annual reporting would impact the timing of our ability to provide comfort on certain periods of interim financial information to the extent an interim review was not previously performed, which would potentially have a significant impact on the efficiency of capital formation. We encourage the SEC to consider feedback from underwriters and preparers on whether the decrease in capital formation efficiency would be material.

¹² See, for example, General Instruction A.1(a) and (b) of Form 10-Q.

¹³ Fu, Renhui and Kraft, Arthur Gerald and Zhang, Huai, Financial Reporting Frequency, Information Asymmetry, and the Cost of Equity (July 10, 2012). *Journal of Accounting & Economics (JAE)* 54 (2012): 132–149 at <https://ssrn.com/abstract=1927696>

¹⁴ For example, audited financial statements of acquired businesses filed under Item 9.01 of Form 8-K.

¹⁵ PCAOB Auditing Standard 6101, *Letters for Underwriters and Certain Other Requesting Parties*, paragraph 46.

Reduction of Administrative Burden

Rule 10-01(a)(5) of Regulation S-X indicates issuers:

...may presume that users of the interim financial information have read or have access to the audited financial statements for the preceding fiscal year and that the adequacy of additional disclosure needed for a fair presentation may be determined in that context. Accordingly, footnote disclosure which would substantially duplicate the disclosure contained in the most recent annual report to security holders or latest audited financial statements, such as a statement of significant accounting policies and practices, details of accounts which have not changed significantly in amount or composition since the end of the most recently completed fiscal year...

We encourage the SEC to work with the FASB to consider how to incorporate the spirit of Rule 10-01(a)(5) in revisions to current U.S. GAAP and any new standards that require interim disclosures. To this end, we suggest the SEC be actively engaged in the FASB's Disclosure Framework Project on Interim Reporting.¹⁶

Transition

We recommend the SEC consider how an issuer would transition to or from different reporting frequencies, whether optional or required, and provide sufficient opportunity for additional feedback from users, preparers, auditors, and other stakeholders on any transition proposals.

Closing

We thank the SEC for providing the opportunity to express our views on questions raised in the Request. Please contact Mark Shannon at [REDACTED] or Brad Davidson at [REDACTED] to answer any questions that the staff may have regarding the views expressed in this letter.

Sincerely,

Crowe LLP

Crowe LLP

¹⁶ https://www.fasb.org/jsp/FASB/FASBContent_C/ProjectUpdateExpandPage&cid=1176170690730