CFA INSTITUTE | Centre for Financial Market Integrity

17 April 2006

The Secretariat CCDG
C/o Accounting and Corporate Regulatory Authority
10 Anson Road #05-01/15
International Plaza
Singapore 079903

Re: *Review of the Quarterly Reporting Requirement*

Dear Members of the Secretariat:

The CFA Centre for Financial Market Integrity ("CFA Centre" or the "Centre")[1], in consultation with its Capital Markets Policy Council (the "CMPC") and the Singapore Society of Financial Analysts (the "Singapore Society"), is pleased to comment on the consultation paper of the Council on Corporate Disclosure and Governance (the "CCDG"), *Review of the Quarterly Reporting Requirement* (the "Consultation"). The CFA Centre represents the views of investment professionals to standard setters, regulatory authorities, and legislative bodies worldwide on issues such as those that affect the practice of financial analysis and investment management, education and licensing requirements for investment professionals, and the efficiency and integrity of global financial markets. The Singapore Society represents nearly 1,700 investment professionals and is a member society of CFA Institute.

General Comments

Members of CFA Institute have long advocated the use of quarterly reporting throughout the world. Among the positions taken with regard to this issue and noted in a 1993 CFA Institute report, *Financial Reporting in the 1990s and Beyond*[2], was that quarterly "interim reporting satisfies optimally the tradeoff between the maximum length of time an analyst should have to wait to receive a report on an enterprise's economic status and the minimum period of time for which meaningful financial measures can be made."[3] The report also noted that quarterly reporting reduced the opportunities for insiders to trade on privileged information.

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[1] The CFA Centre for Financial Market Integrity is a part of CFA Institute. With headquarters in Charlottesville, Virginia, USA, and regional offices in London, Hong Kong, and New York, CFA Institute, is a global, non-profit professional association of more than 80,500 financial analysts, portfolio managers, and other investment professionals in 125 countries and territories of which nearly 68,000 are holders of the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 132 Member Societies and Chapters in 53 countries and territories.

[2] The report was published by the Association for Investment Management and Research which changed its name in 2004 to CFA Institute. CFA Centre is currently seeking global views on the update to this report, *A Comprehensive Business Reporting Model: Financial Reporting for Investors*. This update is found at http://cfapubs.org/ap/issues/v2005n4/toc.html.

[3] *Financial Reporting in the 1990s and Beyond*, 1993, Association for Investment Management and Research, p. 50.

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Those views have not changed. Indeed, in 2003 CFA Institute adopted a similar position when advocating on behalf of its European members about the need for a quarterly reporting requirement in the European Commission's Transparency Directive.

Support of these views on quarterly reporting was further demonstrated by CFA Institute members in Asia. In our Asia-Pacific Corporate and Financial Disclosure survey, conducted in November 2004, 82% of our members in the region said that dissemination of comprehensive quarterly reports was a global best practice that companies in the region should emulate. Just10% said they were indifferent and 9% disagreed. Support among Singapore members of CFA Institute was strong, as well, with 78% saying it was a global best practice to emulate, versus 9% without a view and 12% against it. A total of 683 members responded to this survey.

In the pages that follow, the Centre will respond to the specific questions raised in the Consultation. In every case, the response reflects the support among CFA Institute members globally for requiring companies to provide comprehensive quarterly financial reports to shareowners and investors.

Part I: Profile and Background Information

Question G1: In what capacity are you giving your feedback?

CFA Centre represents the perspective of investors globally. As a consequence the views expressed are those of users of financial reports, including institutional investors, fund managers, retail investors and securities analysts.

Part II: Issues Relating to Quarterly Reporting

Question G2: Do you support the imposition of the quarterly reporting requirements and why?

The Centre and the Singapore Society strongly support quarterly reporting requirements for a number of reasons.

First, timely information is needed by shareowners and investors to make informed decisions about their investment options. The quality of investment decisions can be no better than the quality of the financial reporting, and a major factor in the quality of this information is its timeliness. If investors were not updated about the performance and financial condition of the company at least every three months they would have to guess about it until new information was provided. The consequence of less-frequent reporting would be increased volatility of share prices, particularly prior to and immediately following the release of annual or semi-annual financial reports.

Second, while the required release of such financial information every three months will not eliminate the incentive for earnings manipulation or the incidence of fraud, it does require those who would manipulate earnings to report more frequently. By doing so, quarterly reporting gives

investors more opportunities to uncover any attempts to manipulate the financial reports. It also reduces the time in which insiders can consider how to manipulate what they report, thereby making the manipulation process more difficult and, therefore, more prone to errors and discovery.

Third, quarterly reporting reduces the likelihood that insiders will have time to take advantage of privileged information at the expense of external investors and shareowners. Delaying the release of financial information an additional three months would give insiders a greater opportunity to recognize developing trends in performance, the knowledge of which they or related parties could use to trade ahead of the rest of the market.

Fourth, reporting on financial performance and condition every three months does not encourage management to misreport earnings. Such misreporting of financial results is a function of poor ethics on the part of the reporting parties, and is not a result of the behaviour of users of that information.

Fifth, increased transparency resulting from quarterly reporting enhances shareowner interest in the shares of these companies, increasing daily share turnover, reducing pricing spreads, and lowering capital costs for companies. Studies of pricing changes resulting from changes in transparency requirements of companies in the United States and Europe with publicly listed shares have shown that increased pricing multiples typically develop as a consequence of increased reporting requirements, and vice versa.[4]

Sixth, it is shareowners' funds that the managers of companies are using to prepare this information. If shareowners wish to have the information, they will not penalize management for providing it, so long as it is done efficiently and doesn't reveal problems with the internal controls used to create those reports. Besides, if all companies in the market are required to provide the same kind of information with the same frequency, none will be disadvantaged for doing so.

As this list suggests, there are many advantages to mandating quarterly reporting by public listed companies.

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[4] Two studies are particularly helpful in this regard. The first, "The Economic Consequences of Increased Disclosure," by Christian Leuz and Robert E. Verrecchia (*Journal of Accounting Research*, vol. 38, Supplement (2000): 91-124), shows that German companies that committed to the higher transparency levels of an international reporting regime experienced significant reductions in bid-ask spreads and increases in daily turnover. A summary can be found at http://www.cfapubs.org/doi/abs/10.2469/dig.v32.n1.1001. The second study, "Economic Consequences of SEC Disclosure Regulation," (The Wharton Financial Institutions Center Working Paper Series, February 2003, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=307821), by Brian J. Bushee and Christian Leuz, showed that regulatory changes requiring small firms trading on the OTC Bulletin Board to comply with stricter U.S. Securities and Exchange Commission reporting requirements experienced higher costs that were offset by positive stock returns and permanent increases in market liquidity.
Another article on the subject appeared in the 30 March 2005 edition of the *Wall Street Journal* and was written by Rory Knight, chairman of the management consultancy Oxford Metrica and former dean of Templeton College, University of Oxford. Mr. Knight noted that European companies that established an American Depository Receipts program, thereby subjecting themselves to increased SEC reporting requirements, including quarterly reporting, saw increases in value of between 8% and 10%, while delisting from those requirements destroyed value by up to 40%. (This article is available for a $2.95 fee at http://online.wsj.com/PA2VJBNA4R/article/SB111213449520692373-search.html?)

Question G3:

(i) What do you think of the above-mentioned issues relating to mandatory quarterly reporting?

Reducing the frequency of financial reports to every six months will likely have two effects. First, it will reduce the ability of shareowners and investors to gauge trends in interim performance for an additional three months — delaying the reporting of some transactions by up to nine months. Second, it will likely lead to trading that is based on rumor and innuendo, whether factual or false, and an increased focus on the release of semiannual reports.

Moreover, the pressure that management may feel to produce consistently positive results will not diminish if results are delayed an extra three months. Even if they are required to report only every six months managers will still feel pressure to produce consistent and positive performance. To make matters worse, delaying reporting for another three months will provide management with more time to manipulate results to achieve the positive outcome sought.

The Centre and the Singapore Society disagree with the suggestion that a focus on short-term performance may "inadvertently" drive management to manipulate the accounts. While it is indeed possible that management may inadvertently make mistakes in preparing the accounts, manipulation of the accounts requires a cognitive decision to alter reported performance. Such manipulation is performed to suit the needs and desires of the manipulators, not as a result of an inadvertent act.

Neither the Centre nor the Singapore Society subscribes to the suggestion that quarterly reporting creates greater volatility in share prices. On the contrary, information is the lifeblood of financial markets. Without it investors would be forced to make decisions in a vacuum, one that often is filled by rumor, innuendo, or falsehoods about corporate performance. The result of information embargos, therefore, is reduced knowledge among investors leading to reduced trading activity and wider spreads.

(ii) What are the other pertinent issues relating to mandatory quarterly reporting?

Please see the itemization provided above under Question G2 for a description of the pertinent issues relating to mandatory quarterly reporting.

(iii) Which are the most pertinent issues?

The most pertinent reason for requiring comprehensive quarterly financial reporting is that the information fuels and supports investor interest and trust in companies and financial markets. The increased transparency created by comprehensive quarterly financial reporting not only gives investors important information, but it also reduces the opportunities for insiders to take advantage of an information embargo to manipulate prices and reported performance.

Question U1: What are your experiences in using quarterly reports?

CFA Institute members routinely express strong support for quarterly financial reporting, regardless of the region in which the members live. The primary reasons for this support is that such timely reports enable investors and analysts to stay abreast of a company's progress and performance. The more frequent reports also help market participants recognize trends in performance and progress that enable them to make trading decisions in time to benefit from the knowledge.

The consistent strong support for quarterly reporting among CFA Institute members globally suggests that the frequency of such updates does not create an undue burden on qualified analysts. Rather, the support suggests that reducing the frequency of reporting may make the work of analysts and investors more difficult, rather than easier, as a result of a reduced information flow.

Question U2: Please provide the following further background information (where applicable):

(i) How useful do you find quarterly reports?

CFA Institute members have consistently supported quarterly financial reporting requirements, regardless of their jurisdiction. This suggests that these members find such reports very useful, a perspective that the Centre and Singapore Society endorse.

(ii) What are the key items that you look for in quarterly reports?

Investors wish to receive and review from quarterly reports the same types of information, in unaudited form, that they review in audited annual reports — information about cash flows, earnings, financial condition, assumptions used to create the financial reports, and governance. Furthermore they need to receive such information in a timely and consistent format and with consistent assumptions to enable them to compare recent performance and conditions to prior periods.

(iii) What are your views on the quality and timeliness of quarterly reports?

When CFA Institute members in Singapore were asked about the quality of the information they received from issuing companies, 56% said the information quality was average; 36% said it was good; 2% it was said excellent, and the remaining 6% said it was below average. This is based on 109 respondents from Singapore to this question. These views were somewhat more positive than the average for CFA Institute members in the Asia-Pacific Region, in which 49% said the information quality was average; 35% said it was good; 2% said it was excellent; 13% said it was below average; and 1% said it was poor.

Respondents from Mainland China, Malaysia, and Hong Kong were the most pessimistic about the quality of financial information. Information was rated as below average or poor by

24% of Mainland Chinese members, by 15% of Malaysian members, and by 14% of Hong Kong members.

Australia was by far the most positive about the quality of information, with 64% saying the quality of information was good. Korea was the only other country with more than half of the responses being good or excellent, with a combined 59% in the two categories.

Regarding the timeliness of quarterly reports, CFA Institute has long advocated for shorter reporting times. In doing so, the organization has suggested that companies should publish comprehensive and unaudited quarterly financial reports within 30 days of quarter's end. This will make the information that is made available to investors more useful because it is more relevant to current operations than if the information is embargoed for six months and disseminated three months after that.

(iv) In what other ways are quarterly reports useful?

When financial information is reported every six months and disseminated three months later, the information relates to activities that are as much as nine months in the past. For example, a company that makes a significant acquisition on 10 January of a year will not have to report any of the results relating to that transaction until 30 September.

In the meantime, the embargo on such information has created three possible outcomes. First, it increases the opportunities for insiders to use their knowledge of how the merger has performed to trade ahead of the rest of the market. Second, the internal reports on performance could lead management to manipulate results in an effort to adhere to previously predicted performance. Finally, investors who are not privy to the inside information are forced to guess on how the transaction has performed, potentially increasing volatility in the company's share price, and the potential for loss if investors guess incorrectly.

None of these possible outcomes is optimal for investors, financial markets in general, or even the issuing companies.

Part III: Alternatives and Options

Question G4: What changes should be made to the quarterly reporting requirement?

The Centre and the Singapore Society support requiring companies to provide in unaudited quarterly reports the same type of information that is required in audited annual reports — specifically comprehensive financial statements showing components of earnings, cash flow, and financial condition, together with relevant assumptions and notes to those financial statements, and discussions relating to company governance.

Moreover, given the state of financial reporting and accounting technology available to listed companies, the delay in disseminating this information should be minimal. As noted above, the

Centre and Singapore Society support requiring dissemination of quarterly financial reports within 30 days of quarter's end.

Question G5: Do you think a company should be exempted from quarterly reporting if its shareholders decide that the costs outweigh the benefits of more frequent reporting? If so, should both retail and institutional investors be involved in the decision?

The Centre and the Singapore Society do not favor granting quarterly reporting exemptions to companies with smaller capitalizations.

While quarterly financial reporting is critical to existing shareowners and their ability to decide on everything from whether to continue owing the shares to whether the board is performing its duties, its usefulness extends to others in the financial markets, as well. Outside parties interested in this information include investors — potential shareowners — as well as entities that act as suppliers and customers to the issuer or that are counterparties in other ways.

For example, if the current owners voted to embargo financial reports for six months, it would either force potential shareowners to delay purchasing until the semiannual reports are released — thereby possibly foregoing gains in market valuation — or to buy based on less-than-adequate information — thereby increasing the risk of a bad decision and losses.

Giving current shareowners the right to decide against quarterly reporting also carries the potential for significant abuse in two ways. First, companies in which the majority of shares or votes are controlled by insiders could use a vote for exemption to impose the controlling group's will on other shareowners. The reduced transparency could lead further to a reduction of value for the company shares as external investors reduce their demand for the shares in response to the message such a vote conveys about the governance of the company. While the controlling shareowners also would incur a reduction in value, their values would be bolstered by the control they have over the affairs of the company and its reporting.

The second potential abuse is with insiders who do not own controlling interests. These individuals have a variety of mechanisms available to them — some that avoid financial risk — to acquire control of enough votes to ratify exemption from quarterly reporting. Once exemption is ratified, they could unwind their positions without loss, and enjoy less external oversight of their decisions and management.

It is for these reasons that the Centre and the Singapore Society do not support giving existing shareowners an opportunity to opt-out of mandated quarterly reporting.

Question G6: If mandatory quarterly reporting is to be replaced, what alternative requirements will achieve the same objectives (of timely disclosure, etc.)?

The Centre and the Singapore Society reject the suggestion used by some in other markets that continuous disclosure requirements will achieve the same objectives. Proponents of that view

argue that the regular and frequent updates of relevant corporate events and transactions will provide sufficient information for investors to determine the ongoing performance and condition without having to consolidate that information into recognizable financial statements every three months.

We reject this view because such a regime gives company management significant latitude to determine what transactions or events are sufficiently material to warrant disclosure. Indeed, revenues from *individual* sales of products and services and related expenses typically are not considered material enough to warrant a press release to the market. Without mandating quarterly reporting, therefore, the normal course of business will never warrant reporting, forcing investors to guess about how the company is performing for three extra months.

Consequently, the solution to ensuring that financial markets and their participants receive timely, complete, accurate and relevant financial and performance information is to require companies to provide such information every three months.

Question U3: How can quarterly reporting be made more meaningful to users of quarterly reports?

As noted above, the best way to make quarterly reports more meaningful to users would be to require companies to provide, in unaudited form, the same financial statements and notes that are provided in audited form annually — namely the income statement, cash flow statement, balance sheet, and notes to the financial statements. Requiring companies to disclose relevant assumptions used in creating the financial statements, together with any supplementary data and text that would provide additional explanations of the financial statements, would make the information more meaningful, as well.

Question U4: If the format for quarterly reports is to be simplified, what key information should be presented?

As indicated by the answer to Question U3 above, we do not believe quarterly reports should be simplified. Investors need the information reported in the statements of income, cash flow, and shareowners' equity, the balance sheet, notes to the financial statements and explanatory supplementary information to make informed decisions. Any effort to reduce the quantity and quality of financial information that is available to financial market participants or otherwise summarise it will have a direct and real effect on the financial conditions of investors throughout the world.

Part IV: Quarterly Reporting for Exempt Companies

Question G7: Do you think the need for quarterly reporting is greater or less for exempt companies compared to larger ones, and why?

We believe the need for quarterly reporting is as great for small and medium-sized enterprises ("SMEs") as it is for larger companies. The primary reasons for this view are cited in the Consultation. In particular, these companies pose potentially greater risks to investment capital as a result of less-developed business models and internal control systems, inexperienced management, and less-sophisticated disclosure and communications procedures. Another issue affecting these companies is a relative lack of diversification, both in terms of product offerings and funding sources,

Beyond these reasons, SMEs are more likely to have a group of insiders in control of a majority of the shares, or at least a majority of the votes, in a company. As a consequence, the opportunity for improper use of inside information is greater among these companies, particularly if they have less-developed internal control systems to prevent such abuse. Indeed, one study in the United States found that nearly 75% of accounting fraud cases from 1998 to 2003 involved smaller listed companies. The rate of financial misstatements and restatements for these companies was also twice the rate for larger companies.

Another reason for requiring comprehensive quarterly reporting for SMEs is to ensure continuing investor confidence, both in these companies in particular and the financial markets as a whole. Because these companies are more likely to suffer from insufficient capital or inadequate cash flow, the requirement to update the market every three months will give more opportunities to review the financial statements to determine if the company is generating enough capital to fund its operations.

Question G8: What benefits does quarterly reporting have for exempt companies in particular? [E.g. increased coverage (by research analysts, etc.), increased investor interest (benefits the company), benefits to investors?]

Requiring companies, including SMEs, to report on their financial performance and condition to the markets every three months places discipline and accountability upon management and the board that may not occur if such information is embargoed for six months. If they can't achieve such disciplines, or do not like the accountability, then these companies should not seek capital from such public investors.

However, if companies and their managers are willing to provide such transparency, studies have shown that investors reward them with improved pricing multiples, which translates into lower costs of capital. It also creates a more liquid market for the securities of these companies, thereby reducing the cost of trading for investors.

Question G9: If the quarterly reporting requirement is extended to companies with market capitalisation of less than $75m, should there still be a minimum threshold? If so, what would be an appropriate amount?

The Centre and the Singapore Society believe that the minimum threshold for a listed company to file quarterly reports is that they have securities that are publicly listed on a regulated securities exchange. This includes not only equity securities, but debt securities and other company-based instruments, as well.

Question G10: If there is to be an exemption from mandatory quarterly reporting, is market capitalisation the appropriate determinant? What other factors are appropriate and why?

As noted above, we believe companies with securities listed on regulated securities exchanges should be subject to quarterly financial reporting requirements, regardless of their size, the types of securities they offer, where they are domiciled, the type of industry in which they operate, the age of the company, or the percentage of shares controlled by insiders. If these companies wish to raise capital from private investors, they should be willing to reciprocate that goodwill by providing the transparency those private investors and other financial market participants need to make informed investment decisions. If they do not wish to make such information available, then they should not be permitted to list their securities on regulated exchanges.

The Capital Markets Policy Council of the CFA Centre for Financial Market Integrity, in conjunction with the Singapore Society of Financial Analysts, appreciates the opportunity to comment on the CCDG's consultation paper, *Review of the Quarterly Reporting Requirement.* If you or your staff have questions or seek amplification of our views, please feel free to contact Kha Loon Lee, CFA, by telephone at 852 3103 9303 or by email at khaloon.lee@cfainstitute.org, or James C. Allen, CFA, at +1.434.951.5558 or james.allen@cfainstitute.org.

Sincerely,

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