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CHAPTER X

REGISTRATION STATEMENTS AND REPORTS UNDER THE '34 ACT

A. Introduction

In previous portions of this report, the Study has stressed the interdependence of its recommendations. Thus, the improvement in '34 Act reporting would provide continuing sources of disclosure which could act, to a larger degree, as an acceptable substitute for the special and, at best, occasional disclosures produced under traditional '33 Act practice. Such recommendations of the Study as permitting limited brokerage sales of the privately purchased securities of reporting companies, extending the availability of Form S-7 to a much larger category of issuers, and eliminating the post-effective prospectus delivery requirement for securities of reporting companies, all anticipate substantial improvement in '34 Act reporting.

The phrase "improvement in '34 Act reporting" has at least three aspects: (1) more comprehensive reporting forms, (2) better administration and enforcement of requirements relating to the preparation and filing of such forms. This chapter deals primarily with the first of these aspects. The second will be dealt with in Chapter XII. The third has already been discussed in Chapter IX.

In seeking ways to improve the reporting forms, the Study concentrated its effort on those of primary importance: Forms 10, 10-K, 9-K and 8-K.^{1/} Careful review was given to suggestions relating to these forms which were received from many quarters. Some of these, intended to further the concept of “continuous disclosure”, appeared to involve burdens which outweighed the expected benefits to investors. For example, the Study concluded that continuous reporting of information equivalent to that found in a Securities Act prospectus on a monthly or even quarterly basis was impracticable. The Study also considered it unduly burdensome for the timely disclosure policies of self-regulatory organizations to be duplicated by requiring that current reports be filed with the Commission immediately on the happening of a reportable event. A number of other suggestions (such as requiring a full description of a company’s business in the annual proxy statement) were not adopted because they were inconsistent with the objective of avoiding unnecessary duplication of disclosure.

One aspect of the Study’s work is not treated in this report. In the spring of 1968, the Study carefully reviewed the possibility of

^{1/} The limited facilities of the Study prevented a comprehensive review of all reports and statements required to be filed under the '34 Act. Documents not subjected to critical review include reports required to be made by foreign issuers, reports designed for issuers subject to regulation by certain other government agencies, and various other forms and reports designed for limited purposes.

applying EDP techniques to the processing of ownership reports filed with the Commission pursuant to Section 16(a) of the '34 Act. A combined memorandum reflecting the views of the Study and those of the staff was forwarded to the Commission well in advance of the submission of this Report, since the need for implementation of the recommendations was critical.

The memorandum (1) pointed out the vast increase in the number of ownership reports (from approximately 20,000 in fiscal 1950 to approximately 94,000 in fiscal 1968), (2) noted the grave difficulties being experienced by the Section of Ownership Reports with monthly publication of the Official Summary of Securities Transactions ("Monthly Summary"), and the lapse of enforcement efforts, (3) provided a detailed plan for automating the recording and examination of ownership reports and the publication of the Monthly Summary, (4) listed the advantages of an automated system, including better administration and enforcement of the law and a more complete reporting of transactions in the Monthly Summary, and (5) estimated the costs of the system.

The Commission approved the recommendations.

The Study has one further suggestion to make relative to ownership reports.

Should the Commission adopt the Study's recommendations in Chapter VI relating to secondary offerings, a revision of Form 4 is

recommended to require those who must file reports on that form to designate (possibly by a simple check mark) sales made under the provisions of Rule 162(b). The information thus elicited would be of assistance to the Commission in reviewing the operation of Rule 162, and in providing statistics which could well be relevant in considering any possible revision of the quantity limits imposed by that rule.

B. Basic criteria for '34 Act registration and reporting forms reexamined

1. Reports should be as timely as is practicable without imposing unreasonable burdens on reporting companies

It is axiomatic that informational reports intended to promote the objective of informed public markets should be as timely as circumstances permit. Many persons who consulted with the Study questioned the lengthy interval (120 days after the close of the fiscal year) permitted by the Commission for the filing of the 10-K report. They advised that the report would be far more useful, and would have greater impact on the information made available to shareholders and investors, if it were required to be filed at an earlier date. As explained more fully below (at pp. 352-4), the Study concluded that an earlier filing date for the annual 10-K report is both practicable and desirable.

There is growing recognition in the investment community of the need for prompt, current reporting by publicly-held corporations of material changes in their affairs. Both the New York and American

Stock Exchanges have recently revised and expanded their so-called “timely disclosure” policies.^{2/} These policies are informal in nature. They do not require the filing of specific, written reports. They depend on their implementation upon an active stock watch program.^{3/}

The Commission’s current reporting requirements necessarily play a somewhat different role. They are not intended to, nor could they adequately, duplicate the timely disclosure policies of the self-regulatory agencies. Commission requirements act to a degree as a backstop for those policies; they operate to encourage willingness on the part of issuers to keep the market place informed. They provide details which may be overlooked in the preparation of a news release or may not be included in a published news report. The Study attempted to balance the requirements which it considered essential for meaningful current reports against the time to be allowed for filing them. It also considered how such reports could be best coordinated with other sources of disclosure. The conclusion reached was that a regular, quarterly report would be more useful than the present, irregular 8-K report.

^{2/} NYSE Company Manual, pages A-18 through A-27, revised July 19, 1968. American Stock Exchange Company Guide, pp. 101-108.

^{3/} The NASD also has a timely disclosure policy applicable to corporations whose securities are quoted in its national list. Unfortunately, it has lacked surveillance facilities in the past. The Study hopes that when the new NASDAQ system goes into effect, the NASD will allocate the facilities and resources necessary to effective implementation of its timely disclosure policy.

Both the Commission's staff and interested investors would know when to expect a regular report whereas, at present, neither has any idea when a particular issuer will file its next 8-K report.

One exception to the proposed filing of current information on a quarterly basis is recommended by the Study. That exception concerns the report of a significant acquisition or disposition of assets. The Study is of the opinion that such a report is of sufficient importance to investors to justify a requirement that it be filed within 10 days after execution of a written agreement relating to such acquisition or disposition.

2. Registration statements and reports should be designed to provide information of maximum utility to investors and their advisers

Lengthy conferences were held with various groups to explore the value and utility of '34 Act reports. Representatives of securities firms, institutional investors and investment advisers who conferred with the Study agreed that Form 10-K, despite its present limitations, was by far the most useful of the '34 Act report forms. They advised that no general use was made by them of 8-K reports. Copies of such reports were looked at only on relatively rare occasions as, for example, when a firm was designated the managing underwriter of a public offering and deemed it appropriate to make a detailed study of the issuer. They commented on the fact that large numbers

of 8-K reports contain only one item of information, usually of little or no value in security analysis.

The Study has attempted to make current reports more useful to investors and their advisers. One of the principal omissions in the pattern of '34 Act reporting mentioned by those with whom the Study conferred, including members of the accounting profession, was the absence of a quarterly summary of basic financial information prepared in accordance with reasonably specific standards. The Study recommends that this gap be filled (see pp. 357-8, *infra.*). In annual reports, the principal omission relates to disclosures concerning a registrant's business. The proposed revision of Form 10-K would remedy that defect. The Study questioned the utility of certain existing requirements. For example, it appears that detailed disclosures as to subsidiaries (required in Forms 10 and 10-K) could be simplified. Disclosure of management remuneration has been geared for over fourteen years to a \$30,000 per year figure; in the Study's judgment, that figure could now be raised to at least \$40,000.

In the interest of greater utility, Forms 10 and 10-K have been redesigned:

(a) To group this information in the two forms consistently, each item being given the same numbered designation in both forms; and

(b) To arrange the various items of information in what generally appears to be the order of their importance.

3. Disclosure documents should be coordinated to avoid repetition

Coordination has long been an objective of the Commission in shaping its disclosure policies. Incorporation by reference of documents previously filed is widely permitted by the present forms. Information supplied in a proxy statement need not be repeated in a 10-K report. Other instances could be mentioned; for example, detailed information as to stock options granted to employees (as distinct from officers and directors) has been omitted from the proposed revised Form 10, in view of (1) the disclosures as to options required in the notes to the financial statement, (2) the required submission of any option plan as an exhibit to the form, and (3) the requirement that the dilutive effect of outstanding options be reflected in the summary of earnings.

4. The format of '34 Act reports and registration statements should be compatible with microfiche reproduction and procedures for electronic compilation, storage and retrieval of information concerning a registrant

This objective required attention to three items:

First, in order to permit microfiche reproduction, the pages of a report should be of standard 8 1/2" by 11" size, and large fold-out pages should not be used. Rule 12b-12(a) should be amended accordingly. Financial statements requiring more than a single page should

be shown on opposing or successive pages.

Second, if incorporation by reference is to be compatible with microfiche reproduction, a copy of the document, or pages of the document, containing the data so incorporated, should be physically attached to the filing. Balancing the interests of users of microfiche copies of Commission reports against the interests of registrants, however, the Study would exempt from the requirement of physical attachment all material incorporated by reference as an exhibit to a registration statement or report, such as by-laws, indentures, and material contracts.^{4/}

^{4/} It is not practicable at present to photograph and disseminate bulky exhibits through the Commission's microfiche system. Certain basic documents such as charters, by-laws, indentures and material contracts will therefore not be readily available to interested persons on microfiche. The task of locating such documents at the present time can be very difficult. For example, although a company's by-laws were filed originally as an exhibit to a registration statement on Form 10, changes in those by-laws might be included in any number of annual or current reports.

In order to provide ready access to important documents, the Study strongly recommends expansion of the basic documents program on which a beginning has been made by the Office of Records and Services. Under that program, established to implement the records disposal policies reflected in Rule 24(b) of the Commission's Rules of Practice, separate files designed "X Company SEC Basic Document File" are being erected for the retention of all documents designated in writing by the company as being basic (such as articles of incorporation, by-laws and long term contracts). This program should be expanded to provide (1) for Commission designation of the categories of documents to be included in the basic document file and (2) for the regular inclusion of all materials updating such documents. As an interim measure, the first 10-K filed by each company under the revised reporting requirements should identify the location in the Commission's files of each of its designated basic documents.

Third, if the Commission is to make full use of its EDP facilities in cross-referencing related files, checking noncompliance situations, developing better indices, and producing compilations of statistical and economic data, a so-called “summary sheet” prepared by the registrant should accompany each filing. Appropriate forms for this purpose have been published for consent.

C. Categories of information reviewed from the standpoint of the frequency of reporting

1. The '34 Act Form Chart (Appendix X-1): an aid in reviewing the Study's recommendations

To assist in reviewing the Study's recommendations and to facilitate comparison of the forms and their proposed requirements, a chart has been prepared which will be found in Appendix X-1. The chart lists major categories of information and describes the extent to which such information is proposed to be required in Forms 10, 10-K and 10-Q (the proposed quarterly report form).

2. Business

A description of the registrant's business and of the development of that business in the recent past should be (and now is) required on initial registration. There is presently no provision, however, for a description of important aspects of the registrant's business in the annual updating process. This should be changed. It is a close question

whether any material change in a registrant's business should be required to be described in current reports. The Study reached the conclusion that only specified, highly significant changes (such as a material acquisition or disposition of assets) should be required to be reported on Form 10-Q.

For many of today's corporate enterprises, the key to an understanding of the business and an appraisal of its future prospects is breakdown of revenues and, to the extent feasible, of profits by separate lines of business. All those engaged in security analysis to whom the Study spoke referred to this data as of crucial importance. Last fall, the Commission proposed to add the requirement of such a breakdown to Form 10.^{5/} That proposal remains under active consideration. When the Commission determines the final formulation of the requirement, it should also be added to Form 10-K.

3. Earnings

No single aspect of a registrant's business is of more interest to investors than its earnings. A five year summary of consolidated

^{5/} Securities Act Release No. 4922 and Securities Exchange Act Release No. 8397 (September 4, 1968); revision of proposal published for additional comment, Securities Act Release No. 4949 and Securities Exchange Act Release no. 8530 (February 18, 1969).

earnings should, in the Study's judgment, be required on initial registration as in a '33 Act registration statement. A running 5-year summary should also be provided annually. Condensed, unaudited earnings data should be supplied for each of the first three quarters of the fiscal year. In light of the estimates which must be made in preparing interim earnings statements, they should not be subject to liability under Section 18 of the '34 Act.

4. Capital structure

No separate capitalization table is needed either in the initial registration statement or in the annual updating report. The required financial statements provide the necessary capitalization information. A short statement of capitalization and shareholders' equity in quarterly reports, however, will permit a more adequate analysis of a registrant's financial position than is possible today. There appears to be no reason why information as to a company's indebtedness, of obvious significance to investors, should be made available only once a year -- sometimes following the application of certain cosmetic procedures. Moreover, significant changes in the amount of outstanding securities of any class should be highlighted in quarterly reports, with a brief description of the transactions involved.

5. Property

A brief description of property should accompany an initial filing. Of particular importance is the disclosure of data essential to an analysis of the resources of a company engaged in an extractive industry. This, of course, includes information relative to reserves.

A similar brief description should be provided on an annual basis, including such data as is practicable concerning the resources of extractive industries. There are, however, a number of problems connected with obtaining annual information on extractive reserves, despite its importance to an evaluation of reported annual earnings. The Study recommends that this issue be further explored with the assistance of the Commission's engineers and qualified consultants from industry. It may be found practicable to obtain this data on a periodic basis (for example, every three or five years, unless the registrant has filed a registration statement on Form S-1 in the interim) without imposing a burden out of line with the interests of investors. It may also be practicable in the 10-K report to ask for reserve data on any material new ore body, or oil or gas field, brought into production during the preceding fiscal year. These matters were not capable of resolution by the Study prior to the submission of this report.

On a current basis, information should be required as to the acquisition or disposition of material amounts of assets.

6. Management and control

Information as to directors and officers, their remuneration, their interests in transactions with the registrant, arrangements for their indemnification, and the names of principal holders of securities, should be given on initial registration. Most of this information is provided annually in the proxy statement; it need not be repeated in Form 10-K. Pertinent information should be requested on a more frequent basis as to any new directors or officers, together with data on the interest of any director, officer, or 10% shareholder in any material acquisition or disposition of assets.

Parents and subsidiaries of a registrant should be shown on an initial filing and in the annual updating. Information as to changes in control and as to any contracts or arrangements known to the registrant which may result in a change in control should be reported on a current basis.

7. Description of outstanding securities

Securities registered will be described in the initial filing. Repetition of such description does not appear essential on an annual basis but a reference to where such description may be found might be helpful. Any modification of the rights of holders of outstanding securities should be described in a quarterly report which would include as exhibits, copies of the instruments which accomplished such modification or which authorized any new class of securities.

8. Statement of financial position and other financial information

Balance sheets and the schedules required by Regulation S-X should be required both on initial registration and annually. On a current basis, financial statements of an acquired business which meets an appropriate size test should be required, as is the case today. A statement of the source and application of funds should be provided in the initial registration statement and in the annual report.

9. The market for the registrant's securities

On the initial Section 12(g) registration only, a company should be required to furnish information as to the trading market for its securities, together with representative share price information for a reasonable period.

10. Material legal proceedings

Material legal proceedings should be described in the initial registration statement and the status of pending proceedings should be disclosed annually. Any new proceedings, material interim orders or actions in pending proceedings, and termination of proceedings previously disclosed, should be reported currently.

11. Significant corporate documents

Important corporate documents should be filed as exhibits to the initial registration, as they are now. Changes would be supplied annually, except that certain designated documents relevant to items specified for quarterly reporting, such as material amendments to the registrant's charter or bylaws, would be supplied as exhibits to the appropriate quarterly reports.^{6/}

D. Form 10 -- the initial public reservoir of data concerning a company (Appendix X-2)

Form 10 is the foundation of disclosure under the Exchange Act for registrants which have not previously filed a '33 Act registration statement. It is the filing through which information about the operations and finances of companies which have become sufficiently widely held to meet the minimum standards of Section 12(g) is first made publicly available. Although not required to be circulated directly to investors, it is expected that as a result of faster and more economical methods of dissemination, Form 10 will achieve increased significance in the disclosure system of the federal securities laws.

^{6/} These documents would then be incorporated in the issuer's basic document file described in note 4 on page 336.

1. Recommended changes in format

The proposed revision of Form 10 set forth in Appendix X-2 would rearrange the items of the form in their order of importance. Two of the present items would be combined with other items so that the revised Form 10-K can follow a similar numbering pattern. These items (neither of which is required annually) are: (1) organization, which would be included under “Business” and (2) transactions with promoters where the registration statement is filed within five years of initial organization, which would be included under “Management.”

2. Recommended changes in content

(a) Sales and income by lines of business

As mentioned previously, this highly significant addition is presently under consideration by the Commission.

(b) Other business information

In order to aid the registrant in describing its business, certain specific items (which reappear in the revised Form 10-K) have been added to the instructions. These are:

(i) The dollar amount of backlog of firm orders as of a recent date, and as of a comparable date in the preceding fiscal year, together with an indication of the proportion thereof not reasonably expected to be filled

within the current fiscal year, and any seasonal or other significant aspects of the backlog.

(ii) The sources and availability of raw material essential to the business.

(iii) The importance and effect of all material patents, licenses, franchises and concessions held.

(iv) Any material research activities relating to the development of new products or services or the importance of existing products or services. If research activities are described, an estimate is requested of the dollar amount spent during each of the last two fiscal years on such research which was company-sponsored and on that which was customer-sponsored and an indication of the approximate number of professional employees engaged full time in each such category of activity during each such fiscal year.^{7/}

(v) The number of persons employed by the enterprise.

^{7/} The importance of specific information as to research activities was stressed by all who conferred with the Study. Some companies provide generalized information on so-called research activities which may include expenditures on such aspects of business as quality control. Others give glowing descriptions without figures, or fail adequately to compare the scope of research activities with prior years. The results can be misleading. The American Institute of Certified Public Accountant has, as one of its current projects, the development of a definition of research and development. This work is not yet complete. The language of the requirement drafted by the Study is designed to provide a reasonable degree of certainty without being overly restrictive.

(c) Summary of earnings

A 5-year summary of earnings, similar to the summary usually contained in a '33 Act registration statement, has been substituted for the three year profit and loss statement presently required.

(d) Source and application of funds statement

This recommendation parallels a similar suggestion for the prospectus, and is made for the same reason. (See Chapter III at pp. 90-91).

(e) The market for the registrant's securities

Information as to share price levels and movements is highly relevant to an appraisal of the registrant's securities for investment purposes. It is required in the prospectus and should be included in Form 10.

(f) Financial schedules

It is clear to the Study that certain of the schedules required by Regulation S-X to be included in Form 10^{7a/} are in need of careful re-evaluation. The Study was not equipped to conduct such re-evaluation, however, and is in a position to submit only a few suggested areas for possible change. Many advances in financial reporting have occurred since the requirements for the schedules were first developed, and a

^{7a/} The same schedules are required for Form 10-K.

review of the schedules in light of these advances would be productive.

There is enormous variation of opinion as to the value of a number of the schedules in investment analysis. Generally speaking, financial analysts believe the schedules contain essential information. Many accountants question this judgment. A committee of the AICPA has submitted to the Commission a series of recommendations for revision of Regulation S-X, including the requirements as to schedules. It would be desirable, in the opinion of the Study, for the Commission to convene a series of meetings between members of its staff and representatives of the AICPA, the Financial Analysts Federation, and the Financial Executives Institute to accomplish a revision and simplification of the schedules.

At the request of the Study, a special committee of the AICPA conducted an informal survey regarding the time necessary for the preparation of the schedules, and in particular Schedule XVI (Supplementary Profit and Loss Information). The variation between individual registrants and accounting firms was so large that no very helpful conclusions could be driven from this survey. However, it was apparent that in a large number of instances Schedule XVI consumed more hours in preparation than any other schedule. For this reason, pending possible simplification of that schedule, the Study recommends that registrants be permitted the option of filing Schedule XVI separate from the rest of the 10-K report and with a later due date. See pp. 352-3, infra.

A number of accountants (through a special committee of the AICPA), the Committee on Corporate Reporting of the Financial Executives Institute, and individual financial analysts discussed with the Study their views as to certain of the schedules, or provided the Study with informal written opinions. The Study submits the following brief comments for further consideration in connection with the program, recommended above, for revision of the schedules:

- (1) In general, consideration should be given to the extent to which certain information required by several of the schedules could be simplified in light of the proposed requirement of a statement of the source and application of funds.
- (2) The \$20,000 limitation relating to Schedule II might well be raised, and consideration given to whether information as to the due date, interest rate, collateral (if any) and terms of payment of reported loans would be pertinent.
- (3) Consideration might be given to the inclusion of 50% owned persons in Schedule III.
- (4) Schedule VI should be reviewed in light of the information required to be provided in financial statements by APB Opinion No. 12. Consideration should be given to the question whether depreciation methods and rates should be shown. It is questionable whether the detail as to the accounts to which additions to reserves are charged is essential.

(5) A question is raised as to the need for detail on the accounts to which additions to reserves are charged in Schedule XII.

(6) The essential data required by Schedule XIV should be in a note to the financial statements rather than in a separate schedule.

(7) With regard to Schedule XVI the need for all of the detail under Columns B and C is questioned. The need for information on maintenance and repairs, in light of the practical aspects of gathering the necessary data, is questioned; in any event, a materiality test, expressed in terms of a percentage of total expenses, would seem appropriate. A materiality test should also be developed for management and service contract fees and for taxes other than income taxes. On the other hand, the Study believes that careful consideration should be given to two items not referred to in Schedule XVI which can be highly significant in the analysis of profit and loss information in certain cases. In some industries (toiletries, liquor, packaged goods, etc.), it is extremely difficult to determine the quality of reported earnings without information as to expenditures for advertising. Such expenditures may vary substantially from period to period and may constitute a major portion of total expenses. Subject to an appropriate materiality test which would limit the requirement to industries such as those mentioned above, advertising expense should be shown. Research and development expense is of similar significance in certain industries. Subject to a determination of those particular expenditures which should

be included under “research and development,” a project on which a committee of the AICPA is presently working, and subject also to an appropriate materiality test, this data would be important. Finally, it should be made clear that if any portion of the data required in the schedule is furnished in any other schedule or in the financial statements and notes, that portion may be omitted in preparing Schedule XVI.

(g) Summary of miscellaneous changes

The Study’s other recommended changes of any significance in the content of Form 10 can be summarized as follows: Property -- The expiration dates of material leases should be disclosed. Pertinent information needed by investors concerning extractive industries should be specified more clearly; the Study has worked with the Commission’s engineers in developing new instructions for this purpose; Control -- The existence of pledges of securities or similar arrangements affecting control of the issuer should be disclosed. The names of consolidated or totally held subsidiaries could be omitted in certain situations; Principal holders of equity securities -- Information comparable to that required by Form S-1 should be provided as to the aggregate holdings of officers and directors as a group; Officers and directors -- Additional information bearing upon the experience and background of directors and executive officers should be required, consistent with the similar

change proposed for the prospectus. See Chapter III at pp. 93-95. The term “executive officer” should be redefined to include only those vice presidents who have charge of a principal business function, such as sales, administration, or finance; Options -- A simplified method of disclosing options held by management, consistent with the proxy rules, would be appropriate; Transactions with management -- This item would be revised to conform to the proxy rules.

E. Form 10-K -- An annual updating of information concerning a company (Appendix X-3)

Form 10-K has not fulfilled its proper role in the pattern of disclosure. Other sources of information are now more timely and in many respects more informative. The Study recommends that the usefulness of Form 10-K be increased primarily by requiring it to update significant business information and to be filed at an earlier date. As more fully discussed in Chapter XI, the problem of the misleading annual report to shareholders will, it is believed, be lessened by improvement in Form 10-K.

1. Recommended change in filing date

The Study conferred with groups of securities analysts, accountants, corporate officials, and representatives of the major stock exchanges concerning the timing of the filing of the 10-K. As a result of these conferences, it appears that the 10-K could be filed earlier

than is now required. Several accountants informed the Study that improved auditing methods now in use can greatly reduce any burden imposed by timelier reporting requirements, even for smaller companies. In addition, representatives of the major stock exchanges and a number of analysts expressed the view that there is a definite trend toward earlier publication of annual reports to shareholders. Ninety-eight percent of all companies with securities listed on the New York Stock Exchange and a significant number of companies with securities listed on the Amex published annual reports to shareholders for 1967 within 90 days or less following fiscal year-end. The Study has found no major differences between financial statements in reports to shareholders and those in 10-Ks, except for the schedules required by the latter form.

The Study recommends that the 10-K be required to be filed no later than 90 days after the close of the fiscal year. In order to coordinate the availability of the 10-K report with that of the annual report to stockholders (see Chapter XI), the 10-K should be filed no later than 5 days after publication of the annual report to stockholders if such publication takes place within 90 days after the fiscal year-end. To ease the transition from present requirements, the Study recommends that the proposed 90-day filing deadline not become effective until one year after its adoption. In addition, the revised form provides that Schedule XVI to the financial statements, which is time

consuming to prepare, may at the registrant's option be filed separately at a later date no more than 120 days from the end of the fiscal year.

2. Recommended change in format

The disclosure items in the proposed revision of Form 10-K have been numbered to track the corresponding items in Form 10. (See discussion on pp. 334 and 344 of this Chapter.)

In order to provide easy reference on microfiche to the information available in the Commission's files concerning reporting companies, the Study recommends that the first 10-K report filed by each company on the revised form contain a response to each item of the form without referring to previously filed material, and also contain a list identifying all currently significant exhibits.

3. Recommended changes in content

(a) Sales and income by lines of business

This most important addition to Form 10-K has already been discussed (at 338).

(b) Other business information

Rule 14a-3 of the Commission's proxy rules permits a company soliciting proxies in compliance with those rules to omit any information concerning its business from its 10-K. It was at one time

believed that adequate information on this subject would be provided in the annual report to shareholders which must accompany or precede the proxy statement. The Study's review of annual reports to stockholders, however, led to the conclusion that a substantial proportion of such reports do not contain adequate current business information.

It is therefore recommended that Form 10-K be revised to require disclosure of specific current developments in a company's business. A repetition of the business history required in Form 10 (and also by Form S-1) would not be called for, nor would it be necessary to arrange the information given in any particular narrative form, as would typically be done in preparing a Form S-1.

(c) Summary of earnings and statement of source and application of funds

For the reasons discussed on pp. 338-9 of the chapter, Form 10-K should be revised to require a five year summary of earnings and a statement of the source and application of funds.

(d) Property

Form 10-K does not presently provide for any updating of information relating to properties. It is recommended that the form be revised to include a brief updating. Where mining is of material importance, production data and (if material to evaluation of mine properties) average grade of ore and cost per ton data are, in the

Study's judgment, both practicable and useful to investors. Where oil and gas operations are of material importance, production, gross and net wells and producing acres, and certain associated data would be similarly practicable and useful. As previously mentioned at p. 340) further work and consultation with industry representatives are required to determine whether -- on same appropriate, periodic basis -- information as to reserves should be furnished. The draft revision of Form 10-K does not call for reserve data.

(e) Management

Most of the required information relating to management is disseminated by reporting companies to their stockholders in proxy or information statements. Only a company which does not file a proxy or information statement relating to an annual meeting of shareholders should be required to report such management information on Form 10-K. Necessary changes have been made in the revised Form 10-K so that its requirements will be consistent with the comparable items in Regulation 14A.

The revised Form 10-K also provides for an annual list of all officers of the registrant whether or not a proxy or information statement is filed.

(f) Miscellaneous changes

The following are the more significant miscellaneous changes in Form 10-K recommended by the Study: Description of securities -- The registrant would be asked each year in its 10-K report to identify and indicate the location in material previously filed with the Commission of the most recent description of its registered securities; Pending legal proceedings -- Form 10-K should be revised to require disclosure of the status of pending legal proceedings; such disclosures would coordinate with the disclosures as to such proceedings required by Form 10 and the proposed Form 10-Q; Exhibits -- As discussed on p. 336 of this chapter, the first 10-K filed by all registrants under the Study's proposed requirements should identify those documents previously filed with the Commission containing all currently significant exhibits required by the form; Holders of equity securities -- This information should be reported as of the end of the fiscal year to coordinate with the jurisdictional requirements of Sections 12(g) and 15(d) of the '34 Act; Schedules -- See p.. 346-350, supra.

F. Form 10-Q – A recommended quarterly report to replace Forms 8-K and 9-K (Appendix X-4)

The background of the Study's recommendation that a new quarterly report form be adopted to replace Forms 8-K and 9-K appears at an earlier point in this chapter (at pp. 332-3). Briefly, 8-K

reports are unscheduled. An individual report may or may not cover an item of interest to investors or their advisers at the time the report is filed. For these reasons, they are not widely used. Moreover, it is impossible for the Commission's staff to know, on a routine basis, whether or not a particular issuer has complied with the filing requirement. Many persons advised the Study that a combination of 8-K items with a meaningful summary of financial data on a quarterly basis would be of great usefulness to investors.

1. Quarterly financial reporting

More and more publicly-held corporations are releasing condensed quarterly financial information. Both the New York and American Stock Exchanges require publication of such information by all listed companies, although the standards which they set for such information are minimal. The Study carefully examined a significant sample of quarterly financial reports and releases provided by the two exchanges. It was readily apparent (and acknowledged by representatives of the exchanges) that they varied from extremely useful to extremely poor and uninformative.

Conferences were held by the Study with accountants representing both large and small firms throughout the country, with members of a special committee of the Financial Executives Institute, and with the American Society of Corporate Secretaries, regarding the feasibility

of condensed quarterly financial reporting. The general opinion was to the effect that such reporting was entirely feasible for all companies presently subject to Form 9-K requirements.

It was concluded that a useful advance in disclosure policy could be achieved by developing standards for quarterly financial reporting.

2. Filing date

It is proposed that Form 10-Q be filed no later than 45 days after the close of the registrant's fiscal quarter.^{8/} The financial portion of the report (Part II) would not be required to be filed for the fourth quarter.

As mentioned previously (at p. 333) one exception to the foregoing is recommended: when a significant acquisition or disposition of assets occurs, General Instruction A(c) of Form 10-Q would required a report giving the information specified in item 2 of the form to be filed within 10 days following the execution of a written agreement for the acquisition or disposition which is being reported.

^{8/} Form 9-K is presently required to be filed 45 days after the close of the first six months of registrant's fiscal year. The Study notes that both the FPC and FCC allow a period of 40 days for the filing of required monthly financial reports by corporations subject to their regulatory jurisdiction.

3. Recommended format of Form 10-Q

(a) Part I (Significant corporate events)

Part I of Form 10-Q contains the substance of the 8-K report and would be subject to the liability provisions of Section 18. The following changes have been made in present 8-K requirements, in part reflecting revisions to that form previously suggested by the Division of Corporation Finance: Management and control -- Pledges or other arrangements affecting control of the registrant would be disclosed. Information relating to the experience and background of newly designated officers and directors would be required, consistent with the change proposed for the prospectus (see Chapter III at pp. 93-95) and for Form 10 (see pp. 350-51; supra.); Acquisitions or dispositions of assets -- The test of a significant acquisition or disposition is changed from 15% to 10% of net book value or gross revenues; Increase or decrease in amount of securities outstanding -- The 5% test is retained, except for purchases by a corporation of its own shares, in which case a 1% test is used; Pending legal proceedings -- Any new proceedings, interim orders materially affecting but not terminating pending proceedings, and termination of proceedings previously reported, should be disclosed; Options -- This item should be revised for consistency with the corresponding disclosure item in Form 10; Material amendments to charter or bylaws -- This item should require a statement

as to the effect of any material amendments not disclosed in response to any other item in the form.

For the convenience of registrants and their counsel, a check list of significant events which are required to be reported has been added to the form.

(b) Part II (Financial information)

A special subcommittee of the Governmental Relations Committee of the American Institute of Certified Public Accountants greatly assisted the Study in the preparation of this part of form 10-K. No effort will be made here to go into the requirements in detail; the reader is referred to the form itself and the accompanying instructions (Appendix X-4). The provisions relative to condensed profit and loss information are similar to those of Form 9-K, except for the addition of earnings per share data. The provisions relative to capitalization and stockholders' equity are new.

Certification is not required, but the information must be prepared in conformity with the accounting principles or practices, or methods of applying accounting principles or practices (including consolidation practices) reflected in the financial statements included in the 10-K report for the preceding fiscal year, or any differences which have a material effect on the results of operations must be noted and their effects reconciled or explained.

The information is not deemed to be filed for purposes of the liability provisions of Section 18 of the '34 Act.

If a quarterly report is sent by a registrant to its shareholders containing the information required by Part II of Form 10-Q, such report may be attached in lieu of answering this portion of the form.

4. Exemptions

Rules 13a-13 and 15d-13 under the '34 Act presently exempt certain categories of issuers from filing Form 9-K. If Form 9-K is replaced (as recommended) these two rules should be rescinded. Rules 13a-11 and 15d-11 currently specify the kinds of issuers required to file reports on Form 8-K. The Study recommends that these rules be revised to set forth appropriate exemptions applicable to each of the two parts of Form 10-Q. Drafts of the revised rules are provided in Appendices X-5 and X-6.

The revised rules would exempt from filing Part I of Form 10-Q the same types of issuers presently exempted from filing Form 8-K, viz., foreign governments, foreign private issuers required to make reports on Form 6-K, issuers of American Depositary Receipts for the securities of any foreign issuer, and investment companies required to file quarterly reports pursuant to Rule 13a-12. Added to the foregoing exempt list would be so-called "case flow real estate companies" required to file quarterly reports pursuant to Rule 13a-15, for which

a separate quarterly reporting form (Form 7-Q) would be provided. (See pp. 363 below).

Issuers exempt from filing Part II of Form 10-Q would include: (a) all issuers not required to file annual reports either on Form 10-K, Form 12-K or Form U-5S; (b) issuers in the promotional or developmental stage to which paragraph (b) or (c) of Rule 5A-01 of Article 5A of Regulation S-X applies; and (c) insurance companies other than title insurance companies.^{9/} The foregoing list does not include certain issuers presently exempt from filing Form 9-K. The Study sees no reason why the trading markets should not have the benefit of quarterly financial information concerning bank holding companies and those few banks which are required to file 10-K reports, and suggests deletion of the exemption for such companies. Similarly, producers of a single crop agricultural commodity should not be wholly exempt from interim reporting, but would be permitted by Instruction E(c) to Part II of Form 10-Q to give information for the twelve months ended with the current interim quarter, with comparative data for the corresponding

^{9/} There is today no pattern of quarterly reporting to stockholders by insurance companies. A very few state insurance commissioners require quarterly financial reports to be filed as a matter of routine; others require such reports while an insurance company is in the formative stage. The scope of these requirements should be studied and consultations held with the industry to determine whether forms and procedures for meaningful quarterly financial reporting by life and casualty insurance companies -- designed for the information of investors and their advisers -- can be developed. Meanwhile, the exemption should be continued. (See pp. 214-15, supra, for further discussion.)

period of the preceding fiscal year. Lastly, public utilities and common carriers which file interim financial reports with the FPC, FCC or ICC should not be wholly exempted but should be permitted to substitute copies of such reports (covering the appropriate fiscal quarter) for Part II of Form 10-Q. This will involve no significant burden and will permit dissemination of financial as well as non-financial quarterly information concerning those companies on microfiche.

G. Quarterly reports of certain real estate companies (Form 7-Q)

Companies involved in the management of, or investment in, real property are required to file quarterly reports on Form 7-K if they make cash distributions to shareholders reflecting (in whole or in part) a return of capital. Some 50 to 60 companies are currently subject to this requirement. It would avoid confusion if a separate quarterly report form were developed for this group. Such a form (which could be designated 7-Q) would contain requirements similar to Part I of Form 10-Q and, in addition, the summary financial and cash flow information now required by Form 7-K.^{10/}

^{10/} It will be necessary to revise Rule 13a-15 and 15d-15 (1) to change the designation of the form to 7-Q, (2) to change the period in paragraph (a) to 45 days, (3) to delete the "except" clause at the end of paragraph (c), and (4) to delete subparagraph 3 of paragraph (b) and the whole of paragraph (c).

H. Miscellaneous recommendations

Form 12-K, which may be used by public utilities and common carriers regulated by the FCC, FPC or ICC, should be revised to require appropriate business information on an annual basis in addition to financial statements.