More frequent financial reporting benefits investors

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When it comes to financial reporting, how much information is too much? Public companies in the U.S. file reports every three months to comply with the rules of the Securities and Exchange Commission.

Some critics think that's too often, arguing it focuses companies too much on short-term financial results and too little on long-term efforts such as research and development. In 2013, the European Union abolished the quarterly requirement. The SEC considered a similar move in 2018, although the agency ultimately rejected it.

But new research from Yong Yu, professor of accounting at Texas McCombs, presents evidence for keeping corporate reports quarterly. It finds that more frequent reporting aids investors.

When companies report financial results more often, he finds:

- The added information helps investors better predict future earnings and more efficiently determine a stock's price.
- Companies make additional voluntary disclosures.

"There is a benefit for more frequent reporting," says Yu. "It provides more information to the investors so the stock price can be more efficient."

Making switches

Yu—along with Jenna D'Adduzio of the University of British Columbia, David Koo of George Mason University, and Santhosh Ramalingegowda of the University of Georgia—set out to see whether data could help settle the frequency debate.

The data covered a period from 1954 through 1972, during which several waves of U.S. companies switched from reporting once or twice a year to reporting quarterly. Some did so because of SEC mandates and some because of pressure from the American Stock Exchange.

The researchers did a before-and-after comparison, pairing 201

companies that switched to more frequent reporting with a control group of companies that already reported more often. For each company, they measured how closely current stock returns correlated with future earnings.

Before the switch, the first group of companies' returns were 36% less predictive of long-term future earnings than returns in the control group.

After the switch, after companies started reporting more often, their returns became better correlated. They were only 7% less predictive than those in the control group.

In other words, Yu says, their investors did a better job of forecasting long-term future earnings and incorporating them into current stock prices.

More is better, to a point

The findings have practical implications for SEC policymakers and investors, alike, Yu says. Investors should be reassured that when it comes to financial reporting, more does seem to be beneficial in terms of providing information.

Policymakers should balance the benefit to investors of frequent reporting against the higher cost to companies—especially to smaller businesses—as well as worries about focusing excessively on short-term results.

One option, he suggests, could be to allow different frequencies for different kinds of companies. The SEC could relax reporting requirements for smaller companies, or those in more volatile industries, while keeping the requirement of more frequent reporting for others. Says Yu, "Maybe somewhere in between is really the best that

policymakers can do."

The findings are published in the journal *Accounting Horizons*.

More information: Jenna D'Adduzio et al, Does More Frequent Financial Reporting Bring the Future Forward?, *Accounting Horizons* (2024). DOI: 10.2308/HORIZONS-2022-030

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