Weighing the Necessity and Benefits of Disclosures

John Kelsh, partner at Sidley Austin LLP, and Kristopher Peterson, director at Navigant and adjunct professor at St. John's University, comment, in turn, on the relevant requirements and considerations in making the decision as to whether financial and non-financial information needs to or should be disclosed.

From a legal perspective, what must public companies take into account when considering disclosures?

John Kelsh: With respect to financial disclosures, public companies must, of course, comply with accounting standards in the manner required by the Securities Exchange Commission (SEC). In addition, 10-Ks and 10-Qs must include "Management's Discussion and Analysis of Financial Condition and Results of Operations," which is intended to permit stockholders to see the company "through the eyes of management." This disclosure is often challenging to prepare, in part because it must incorporate forward-looking information, including information in some cases regarding known demands, commitments, events or uncertainties that are reasonably likely to have a material effect.

With respect to non-financial disclosures, the SEC has adopted a large number of complex regulations with which issuers must comply. These include regulations relating to matters such as executive and director compensation, corporate governance and related party transactions. As is the case with financial disclosures, the SEC has issued a large number of interpretive releases and FAQs that provide the reporting community with a sense of what the SEC staff thinks is important and how it interprets its own rules.

One question that often comes up as we advise clients in their preparation of disclosures is whether, and to what extent, they should go beyond minimum disclosure requirements. There are certainly many situations in which going beyond minimum disclosure requirements is appropriate and just about every public company includes some disclosure that is not, as a technical matter, required. We think, however, that it is important for companies to proceed cautiously in this area, as there are a host of problems that this can create. If there are errors in the non-required disclosure, this can create litigation risk. Additional disclosure can also create a precedent and lead to expectations from analysts that the extra disclosure will always be provided and that other, similar forms of disclosure should be provided. Finally, and perhaps most importantly, to the extent that the additional disclosure relates to contingencies that are appropriately considered immaterial, including such additional disclosure can muddle rather than clarify the picture for investors regarding the company's long-term prospects.

From an ethical perspective, what other considerations are relevant when considering disclosures?

Kristopher Peterson: Reporting speculative or vague information can certainly prove harmful in some circumstances, but if we consider all of the stakeholders for a given firm, disclosures would ideally address the firm's fulfillment of all of its direct and indirect obligations to those stakeholders. Although the company may not be required to make a particular disclosure, taking steps toward increased transparency can demonstrate that firm leadership is holding itself to a higher standard. This can help build an effective ethical culture that could positively impact the long-term value of the firm.

Firms perceived as ethically sound can reduce actual and perceived business risks and these reduced risks could lead analysts and investors to ascribe a higher valuation to the firm. Alternatively, minimal disclosures on information such as environmental, social, and governance factors could result in firms being viewed with more uncertainty in relation to their peers, which could translate into lower valuations. Firms that establish an ethical reputation may also gain access to capital or financing terms that they would not otherwise enjoy, may find it easier to attract more talented employees, and may also gain more clients and customers. Finally, a strong ethical culture could lower employee-monitoring costs and function as an early warning mechanism for identifying mounting risks before they become material or catastrophic. This proactive approach will often prove to be far less costly than the penalties imposed by regulators or the market.

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