



CHAPTER 20

10-Q AND 10-K FILINGS



BUSINESS BEATS BASICS

10-Q AND 10-K FILINGS

INTRODUCTION

If you want to understand how a public company is doing, the answer is often close at hand, in its most recent quarterly or annual report filed with the U.S. Securities and Exchange Commission (SEC). These are mandatory reports that publicly traded companies in the U.S. must file with the SEC and are named after the form they are filed on, the 10-Q (quarterly report) and the 10-K (annual report).

Companies file 10-Qs three times a year, within 40 to 45 days after the end of their first, second, and third fiscal quarters. The fourth quarter brings an annual report, filed on Form 10-K that must be filed within 60 to 90 days (depending on the size of the company) of the end of the fiscal year. Many companies' fiscal years follow the regular calendar – with quarters ending March 31, June 30, Sept. 30, and Dec. 31 – but there are exceptions. For example, many retailers end their fiscal year on Jan. 31 to capture the full Christmas-to-New Year's selling season in one quarter. Knowing when a company closes its books for the quarter gives you a good sense of when its 10-Qs, and ultimately its 10-K, will be filed.

At first glance, these filings can be daunting. They're loaded with numbers, tables, and dense paragraphs of business and accounting jargon. And they can range from a few dozen pages to hundreds of pages in length – the former Bed Bath & Beyond once filed a 10-K that was 485 pages.

These reports are supposedly published by the company for the company's shareholders and potential investors, but they sometimes read as if they were written by the company's lawyers purely for regulators and other lawyers. Despite this, these reports serve up the most comprehensive picture of a company available to outsiders.



WHERE TO BEGIN

Think of a company's three 10-Q filings as a quarterly progress report. By contrast, the 10-K actually does double duty: It's the quarterly report for the final quarter of the company's fiscal year and offers a summation of the full year. In the 10-K, you can get an aerial view of the company's operations, from its business lines to its properties and market performance. You will find updates on a lot of crucial kinds of developments, from lawsuits and regulatory inquiries to the laundry list of risks the company faces. And you get management's interpretation of it all – plus, in some cases, the original documents and contracts that underlie important developments.

While the company may feature glossy, colorful reports on their website or mail them to investors, those reports amount to marketing documents – even if they draw on the same underlying information that you can find in the 10-Q or 10-K. To find the information they don't want to highlight, head straight to the SEC's website to find the company's latest 10-Q or 10-K. What is reported in these filings may very well be the closest thing to the unvarnished truth that you'll find outside confidential internal documents.

Note: Some private and foreign companies also issue quarterly and annual reports, but they do not have to follow SEC guidelines, and their reports may look very different from the 10-Q & 10-K.

SEC'S EDGAR

To find a company's 10-Q and 10-K forms, start with the SEC's EDGAR search page using the company's name or ticker symbol (the abbreviation used to identify a company on a particular stock market, ex. Apple is AAPL on the NASDAQ). Once you pull up a company's filings using the SEC [search function](#), you can set the results filter to show only the 10-Q or 10-K filings.



ALL REPORTS ARE NOT EQUAL

Don't confuse 10-Q or 10-K filings with a company's quarterly earnings report. There's overlap between the two, but they are very different. The earnings report is essentially a press release where companies can emphasize the good news and downplay, or even omit, the bad news – with limits. This is something that is harder to do with 10-Q filings, and the 10-K is even more restrictive. In some instances, developments that can be left out of a quarterly report must ultimately be disclosed in a 10-K, unless companies want to face the eventual wrath (and potential lawsuits) of their regulators and shareholders.

Even where it includes a range of financial data, an earnings release typically contains only a fraction of the detail of a 10-Q or 10-K.

The earnings release often comes out first and by the time the 10-Q or 10-K comes out – whether that be days, weeks, or even mere hours later – most reporters, and many investors, have moved on to something else. Don't make that mistake.

In addition to any hints of future developments that may interest investors and your audience, the 10-Q will include any bad news that companies would rather ignore. While the 10-Q is still written by company officials for public consumption, companies have legal obligations to disclose certain kinds of information in a 10-Q filing, however unpleasant it may be.

BASICS OF THE 10-Q

For reporters, some of the most useful parts of the quarterly report look like intimidating blocks of boilerplate and jargon. You'll learn how to understand those sections later in this chapter, but it will help to first understand how investors generally look at 10-Q filings. For most of them, the heart of the 10-Q is the financial statements. For those new to examining a company's financial statements, a few basics will help you get started covering public companies.

The core of a company's financial statements consists of four parts: the balance sheet, income statement, statement of cash flows, and statement of comprehensive income. They offer investors and others four ways to weigh a company's health and operations. We'll go over the first three parts, as they are the most useful to reporters.

BALANCE SHEET

A balance sheet is a snapshot of a moment in time: where the company's books stand at the close of business on a specific day – the last day of the quarter (or year). It doesn't tell you much about what happened over the course of the quarter unless you compare it with a previous balance sheet. The balance sheet is divided into two main parts: assets and liabilities.

ASSETS

These are resources owned or controlled by the company and can include any of the following:

- Cash or cash equivalents (e.g., short-term bonds) that can be liquidated quickly.
- Investments and other longer-term financial assets.
- Tangible items: Physical property, often labeled as "property, plants and equipment."
- Intangible items like intellectual property (patents, brand names) and goodwill (an accounting construct that represents the difference between the market value of an acquisition and what the buyer paid for it).

LIABILITIES

These are any debts or obligations the company owes to someone else. This can include:

- Bank loans and mortgages.
- Accounts payable: includes all the bills a company owes but hasn't paid as of the quarter closing date, such as employee wages which may go out with the following week's payroll.
- Post-employment benefits such as pension plans that an employer promises to pay current workers in the future upon retirement.

Debt in itself isn't bad – even healthy companies flush with cash may take on debt. But sudden increases in debt can be a sign of trouble (or of an impending acquisition). Liabilities are generally categorized as current (due within a year) or long-term. As time goes by, a given liability shifts from a long-term liability to a current liability – for example, as a loan nears the end of its terms.

INCOME STATEMENT

If the balance sheet is a snapshot in time, the income statement – also called the profit-and-loss statement, or P&L – is more a summary of financial events over the prior quarter.

Most companies sell products or services that generate revenue. You'll see terms such as "gross revenue" and "net revenue," but revenue roughly amounts to a company's sales for the quarter (or whatever period is covered by the income statement).

Revenues are offset by expenses of what it costs to run the business, from salaries and benefits to simply keeping the lights on. "Cost of goods sold" counts whatever goes directly into producing the company's products and services, including raw materials and labor (wages).

Operating income is roughly what the company makes from its actual business – selling burgers, cars, consulting services, etc. It excludes things such as taxes, interest paid to lenders and stakes in joint ventures or outside companies. Those excluded elements are included when it comes to net income, the infamous bottom line (because it typically appears near or at the end of an income statement).

Net income measures profits, and earnings per share is simply net income divided by the number of shares outstanding.

STATEMENT OF CASH FLOWS

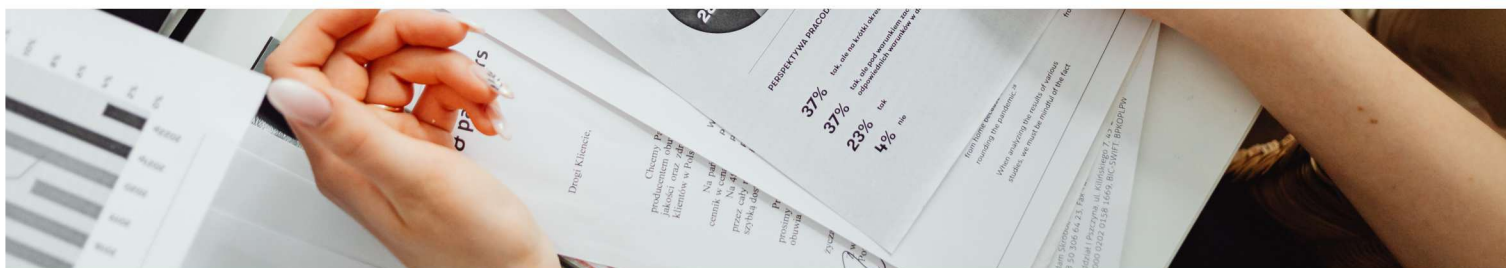
Be careful: Revenue doesn't necessarily mean cash in the door, and companies can't always take profits to the bank. That's because cash and income are different when it comes to big-company accounting. Very small companies often function on a cash basis.

Here's one way to think of it: If a company closes a big sale to a customer on March 31, it can count as revenue even before any cash reaches the company's bank account.

Moreover, the company can record an expense for a plant's power bill for the first quarter even if it doesn't actually cut the check to the electric utility until the following quarter.

Some investors rely heavily on cash flow, seeing it as a more reliable picture of a company's activity. Cash flow breaks down into four areas:

- Cash from operating activities, which is what it sounds like
- Cash from investing activities, including long-term securities portfolios or real estate
- Cash from financing activities, which includes dividend payments and stock buybacks
- Supplemental information, typically taxes and interest paid



ANATOMY OF THE 10-K

While the 10-K comes out only once a year, it's more comprehensive than the 10-Q. For example, companies must provide an annual employee headcount in the 10-K, but many don't update it each quarter. The 10-K also is more robust: that's because the 10-K must be audited by an outside accounting firm, while the 10-Q is simply "reviewed" – a less rigorous standard. It rarely makes a difference, but it's worth keeping in mind: if a company's management wants to cut corners or push the envelope on managing the books, it may be a little easier to do so in quarterly reports.

PART 1

ITEM 1

BUSINESS

Here, the company describes what it does (often with a smidgen of corporate history). It also breaks its operations down into different business lines and markets, describes its competition and workforce, and touches on the significant labor or regulatory issues it faces.

ITEM 1A

RISK FACTORS

Much of this section is dry and dull, and new additions can be predictable. After the massive earthquake, tsunami and nuclear disaster in Japan in March 2011, for example, plenty of companies suddenly began disclosing the risks that earthquakes and nuclear accidents might pose. Still, absent that kind of sweeping development, lawyers are a conservative bunch: They rarely change things without a reason. If you see a new risk factor in a company's 10-K, or language changes significantly from one filing to the next – especially if the reason isn't apparent – it's probably worth trying to find out what's going on, either at the company or in the industry more generally. At the very least, you may have found a trend story.

ITEM 1B

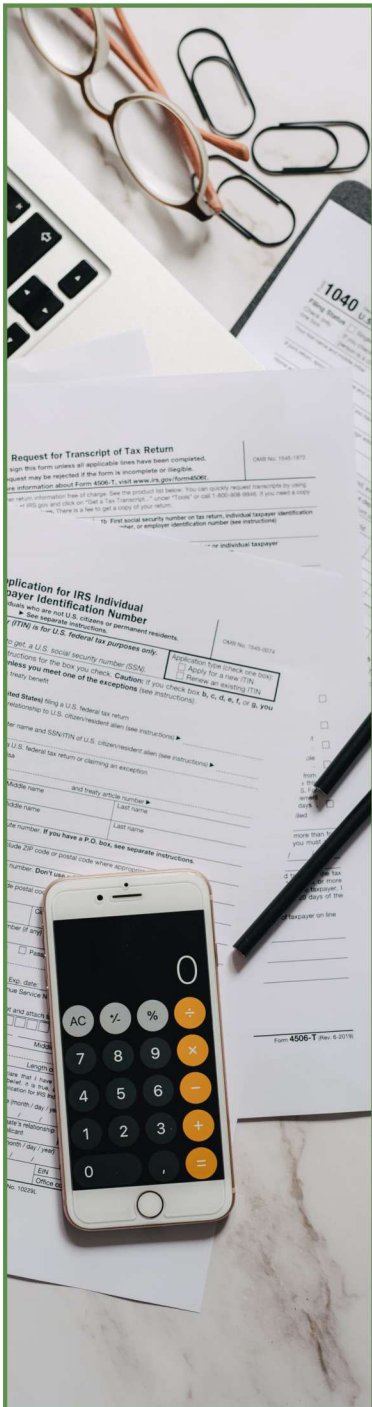
UNRESOLVED STAFF COMMENTS

In theory, if a company is still bickering with the SEC staff over disclosures in a previous filing – typically because the agency wants the company to disclose more than management would like – it should show up here.

ITEM 2

PROPERTIES

Gives you a sense of how big and far-flung a company's physical operations are. Small companies list every facility they own or rent; others list the most significant ones, and big chains tend to list aggregate numbers by state or country, as appropriate. Either way, spotting changes here can be illuminating.



ITEM 3

LEGAL PROCEEDINGS

A rundown of all the litigation and regulatory proceedings that the company faces. Often, companies have already disclosed all but the most recent developments listed here, but that isn't always the case, so look closely. Companies are supposed to disclose the potential size of their legal liabilities in a couple of different ways. First, they should book a reserve for legal liabilities that are both likely and can be reasonably estimated. That leaves a lot of wiggle room, and corporate managers tend to assume they'll win most or all the cases they fight, claim they can't possibly estimate how big a hit a given lawsuit will inflict, or argue that they expect to win on appeal. Secondly, disclosure rules require companies to disclose an estimate or range for reasonably possible losses from litigation, even if those losses aren't considered "likely." Not surprisingly, companies often declare such estimates are impossible, getting them off the hook. Occasionally, however, they do provide eye-opening numbers. Goldman Sachs, for example, said in its 10-K for 2012 that it was reasonably possible that the company could lose as much as \$3.5 billion for those cases where the company can estimate potential losses.

ITEM 4

RESERVED FOR FUTURE RULEMAKING

This item has no required information, but is reserved by the SEC for future rulemaking.

PART 2

The second major chunk of the 10-K goes more deeply into the numbers and much of the mysteries of a company's operations and financial activity – but don't let that scare you off.

ITEM 5

MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Lays out basic data about the company's shares, including high and low prices; often an average price; and details on dividends and stock repurchases. You can often get more current or easier-to-read data from Yahoo! Finance, Reuters, Morningstar or similar financial data sources. Still, if you need a snapshot for a particular time period, this section can be handy.



ITEM 6

SELECTED FINANCIAL DATA

These aren't the company's complete financial statements, but rather a look at some of the most significant elements. Among other information, it typically shows five years of major line items like revenues, operating expenses, net income, etc.

ITEM 7

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Often called the MD&A for short, this is where the company's management walks investors through the financial results: Why did revenue fall and operating expenses rise? What drove a decline in the effective tax rate? If the financial statements, and the income statement in particular, summarize what happened in the quarter, the MD&A is the place to find out why and how it happened.

ITEM 7A

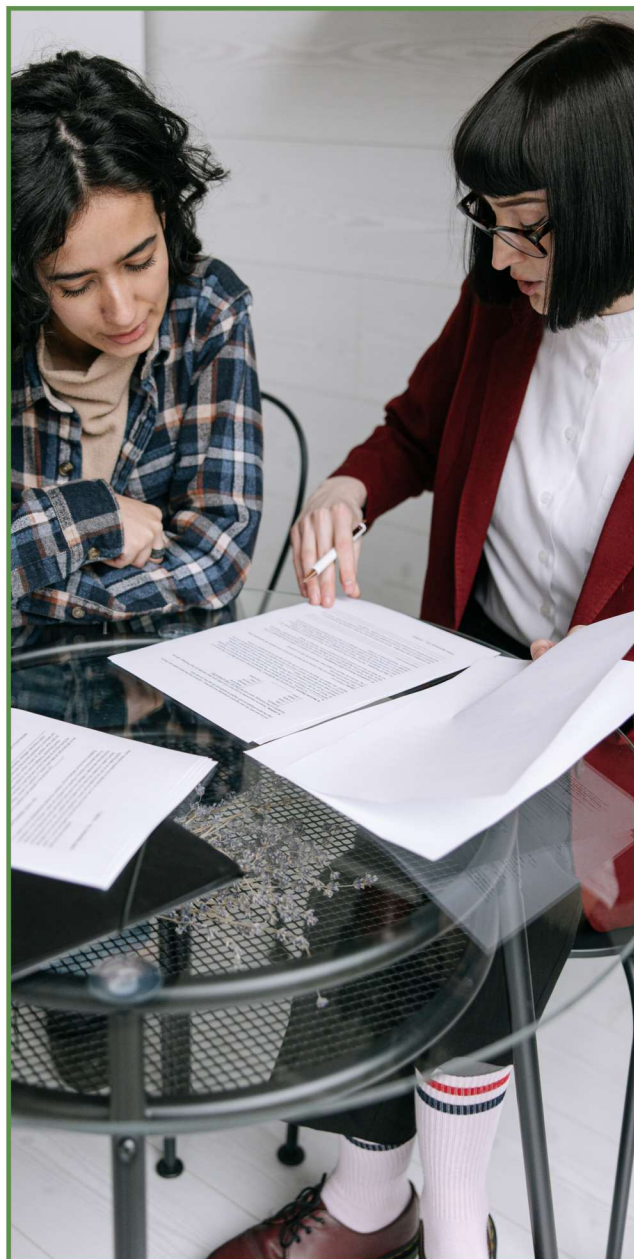
QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

If you're trying to understand a company's vulnerability to currency fluctuations, commodity prices, or interest rate shifts, this is a great section to look at.

ITEM 8

FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

For many, the full financial statements included here are the heart of the 10-K. Keep in mind that the annual financial statements in the 10-K are audited, meaning the company's outside accounting firm has gone through them and (except in rare circumstances) found nothing unexpected. That's no guarantee that everything is above board, but it serves as one line of defense for investors.



FOOTNOTES

The infamous footnotes can be lengthy – some sprawl for pages, and they go into minute detail about the company's taxes, pensions, stock-based compensation, accounting methods, etc. For the most part, these sections break out important information that isn't immediately obvious from the financial statements themselves – such as how a particular tax figure was derived.

ITEM 9

CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Requires a company to discuss any disagreements it had with accountants if there was any change in who does their accounting. Accountant changes can be a red flag, particularly when a large company switches from a big, well-known accounting firm to a small, lesser-known one. Actual disagreements are rare, but likely serious if a company can't resolve them by the 10-K deadline. This is also one place you might find the company's Report of Independent Registered Public Accounting Firm, a kind of report card from its outside auditor. If all's well, the auditor reports an "unqualified" opinion and says the company maintained "effective" controls over its internal controls and financial reporting. Anything else – especially language questioning whether the company is a "going concern" or providing a "qualified" opinion (or disclaiming any opinion) – is probably news.

ITEM 9A

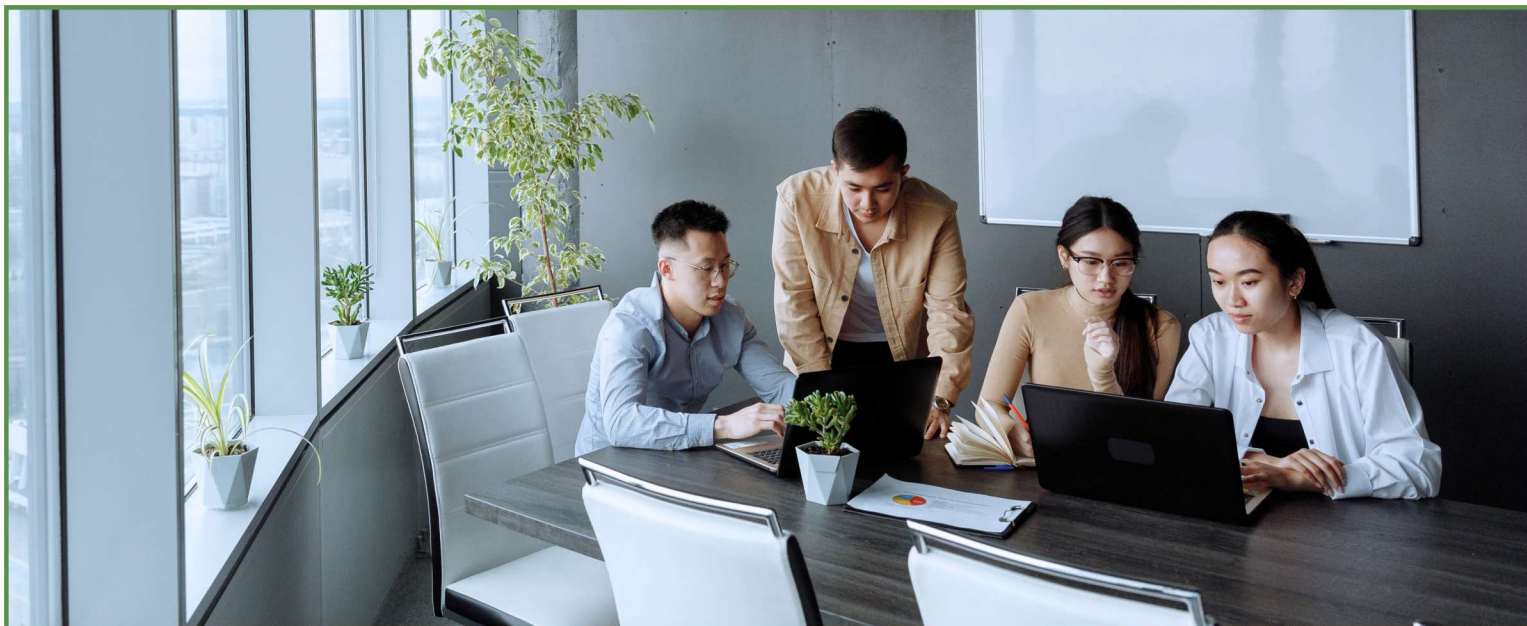
CONTROLS AND PROCEDURES

This section details any problems with the way the company polices its own disclosures and financial reporting. Of course, by the time problems show up here, investors usually already know, thanks to earlier 8-K (see Chapter 19) filings, accounting restatements or news reports.

ITEM 9B

OTHER INFORMATION

This is one of the last substantive sections of most 10-K filings. As its name suggests, it's a catch-all, and some companies use it to report "subsequent events" – developments that occurred after the end of the fiscal year, but before the 10-K is issued. It should also include any significant developments that would ordinarily have been reported in an 8-K or another filing but are being wrapped into the 10-K due to timing.

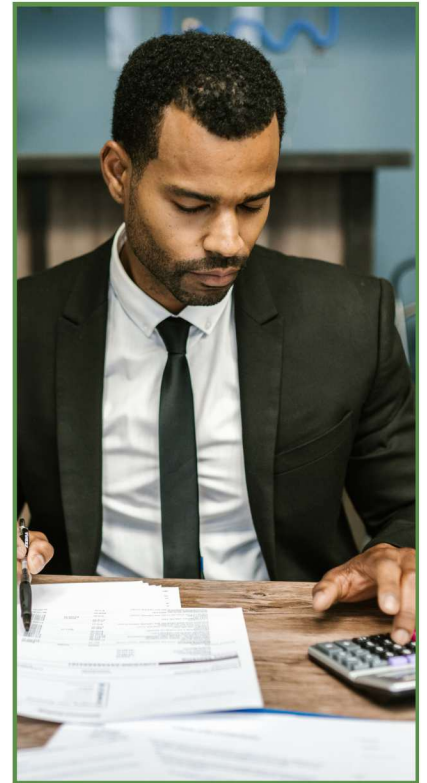


PART 3

ITEM 10- 14

- Item 10** Directors, Executive Officers and Corporate Governance
- Item 11** Executive Compensation
- Item 12** Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters
- Item 13** Certain Relationships and Related Transactions, and Director Independence
- Item 14** Principal Accountant Fees and Services

Most companies don't include much in the third section of the 10-K. That's because it's designated for material that usually goes into the annual proxy filing if companies file that document within a set timeframe. Most do. You can learn more reading about proxy statements in Chapter 21. Still, if you can't find a company's annual proxy, check these sections for information about directors and top executives, including compensation, stock holdings, and potential conflicts of interest.



PART 4

ITEM 15

Part 4's only section, Item 15 – Exhibits, is also straightforward: It includes any number of additional documents (exhibits) filed along with the 10-K. In EDGAR, you can access exhibits from the index page that appears when you first pull up a specific filing (the same place you click to open the body of the 10-K itself).

The exhibits can include a wealth of detailed information about a company's operations, internal policies, and more. A few are in nearly every 10-K, including Exhibit 21, which lists a company's major subsidiaries. Others are simply routine, like the certifications signed by a company's chief executive and chief financial officer.

Exhibits are coded according to broad content areas. So exhibits numbered with a 10 – e.g., 10.3 – are material contracts, including executive pay agreements. Exhibit 21 is a list of subsidiaries; exhibits numbered with a 14 are ethics codes or related policies. Exhibit 99s are often press releases.

Many exhibits are routine, and potentially sensitive information is often redacted, especially from contracts, but it's worth taking a look at what exhibits accompany a filing. If a particular exhibit is befuddling, check the body of the 10-K – often it's mentioned in there somewhere.

TIPS AND TRICKS

The 10-Q and 10-K are multi-purpose tools. You can use them to break news, to get a better understanding of the companies you cover, or simply for reference to fill in the gaps as you report and write.

COMPARE AND CONTRAST PERIODS

Quarterly and annual reports are, first and foremost, intended to update investors on new developments. As a result, most of the emphasis is on what happened in the just-ended quarter.

At the same time, the significance of what just happened often depends on what came before. So most 10-Qs offer comparisons to prior quarters, and 10-Ks will often have year-to-year comparisons, both in tables and in the text as a whole. Tables showing revenue or expenses, for example, will give figures for the most recent quarter and the same quarter a year earlier. This “year-over-year” comparison helps account for seasonal fluctuations, like spiking toy sales around Christmas, for example.



Occasionally, tables or text will compare the most recent quarter to the immediately preceding quarter. That can be useful as well. Just make sure you differentiate between this kind of sequential comparison and the more

common year-over-year comparison.

A third kind of comparison provides year-to-date figures. You won't find this in 10-Qs covering the first quarter of a company's year, but you are likely to in subsequent quarters. So the second-quarter 10-Q might list both the current quarter's results and results for the first half of the year; a third-quarter 10-Q would include cumulative figures for the first nine months of the year, in addition to the most recent quarter's results.

Year-to-date figures can make it easier to see the big picture, but be careful that you don't inadvertently confuse them with quarterly numbers.



HOW TO COMPARE TEXT

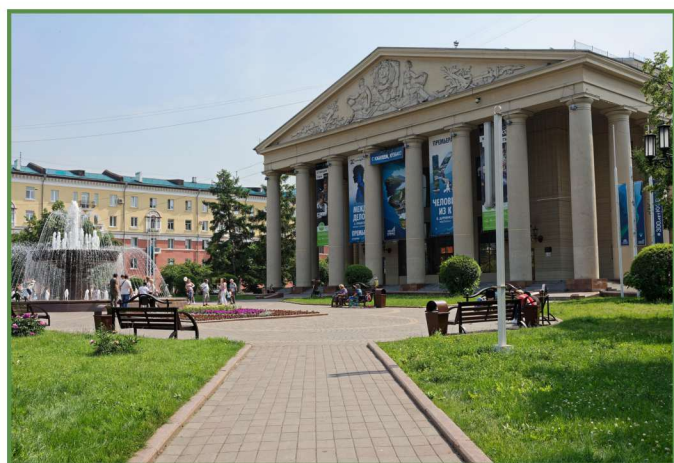
It's tough to find new details in filings that are dozens or hundreds of pages long. Luckily, a host of tools make this easier. A variety of paid services makes it easier to find specific words and phrases across multiple filings. All have different features, and some have given news organizations discounted access in the past, for publicity's sake. Among the companies offering expanded filing services are [MorningStar Document Research](#) and [AlphaSense](#).

[SEC Info](#) is a free service provided by Fran Finnegan & Co. It does many of the things that the paid services above will do, although the site's interface can be less intuitive.

Another way to compare filings or parts of filings is using the compare documents feature in Microsoft Word or its alternatives, such as LibreOffice. For shorter passages, also check out textdiff.com or other online text-comparison services.

INLINE XBRL

Historically, 10-Qs and 10-Ks are just long text documents, with a little bit of HTML formatting to create tables and make the documents more readable. Most companies now file certain kinds of information in a “structured” format called XBRL, for “eXtensible Business Reporting Language.” Much more information about XBRL is available on SEC's website, but it essentially allows tabular information to be displayed more quickly and consistently. That can be useful if you need to quickly pull up a company's income statement or balance sheet, or tables showing its geographic markets.

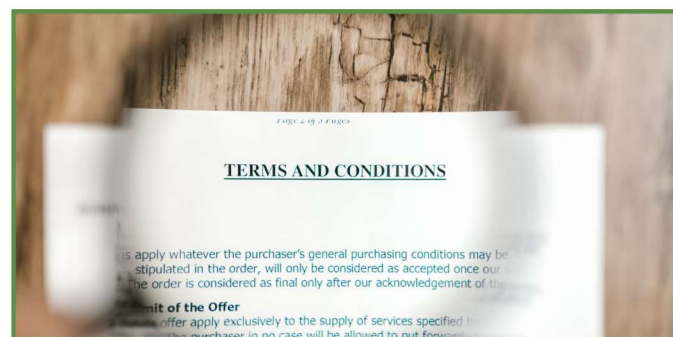


GOING TO THE COURTHOUSE

Companies are required to tell investors about significant legal proceedings and update those disclosures each quarter. It isn't uncommon to see just a few lines here in this section with a reference to the most recent 10-K filing or another 10-Q. That typically indicates that there has been no significant change since the last filing.

When there have been new developments, a few companies make it easy, disclosing only the new details. Sometimes that means you have to refer back to earlier quarterly reports (or the most recent annual report) to get the full picture, but at least you know what's new.

Other companies simply reprint the entire legal proceedings disclosure, tweaking the phrasing or adding a few words or sentences as required. Be careful: Companies aren't obliged to report developments chronologically or make it easy to see changes. Spotting changes sometimes means looking at sections of two filings next to one another and comparing them line by line.



RISKY BUSINESS

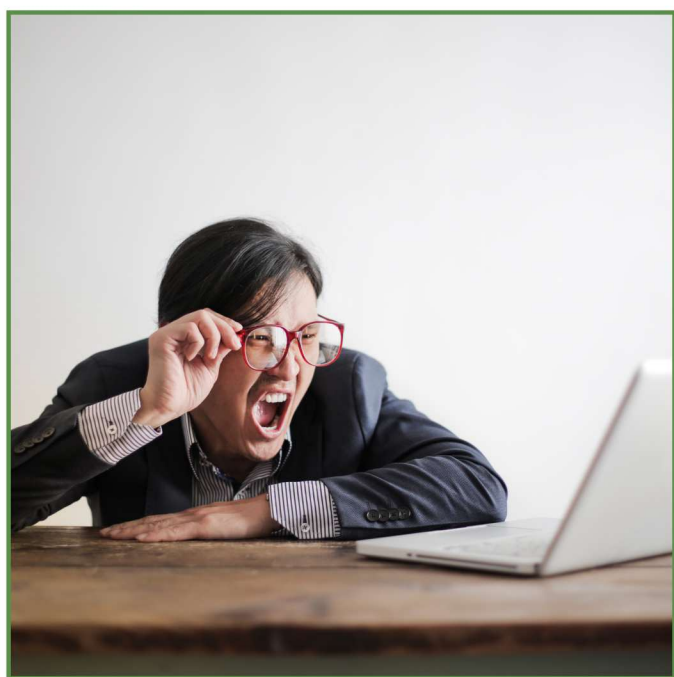
Every business faces risks, and companies are supposed to tell investors about any that are apparent. The main home for these disclosures are in a section of a company's 10-K titled, “Risk factors,” but any changes that have occurred since are supposed to be reflected in the 10-Q.

Just as with legal proceedings, companies update their risk factors in different ways. Some simply reprint their entire risk-factors disclosure every quarter; it's up to you to figure out what's changed (again, sometimes through painstaking line-by-line comparisons).

Other companies are friendlier, and include in their 10-Qs only new risk factors, or those that have changed. That sometimes means

reprinting several paragraphs even though only a sentence or two has changed. Either way, check this section.

Much of what shows up here is boilerplate, the legal equivalent of a company covering its bases. But changes are often worth looking into: Securities lawyers rarely add information for fun, and the changes could tell you something about problems the company is anticipating.



BE CONCERNED (VERY CONCERNED)

One of the hot buttons for investors worried about a company's future is the "going concern" clause. It should be a concern for employees, customers, and others as well.

The clause is among the strongest warnings that a company's auditor can issue and indicates that the company could face liquidation. It often notes "factors [that] create substantial doubt as to the Company's ability to continue as a going concern" – or words similar to those.



Going concern clauses are unusual, but if you're looking at a company thought to be on the brink, it's worth taking a look. The clause can appear under a heading such as, "Basis of presentation," within the company's Summary of Significant Accounting Policies. Or just search for the phrase "going concern" and read carefully.

AFTER THE FACT

In the past, companies tended to include a section titled "Subsequent events," disclosing developments of significance that occurred in the month-and-a-half or so between the end of the quarter and the reports publication. A few still do this; others might mention subsequent events throughout a quarterly report, in relevant sections. Keep your eye out for the term (or search for it) and for mentions of dates after the end of the quarter. They typically indicate the newest developments – ones that might not yet be on your audience's radar screens.

JUDGE BY THE COVER

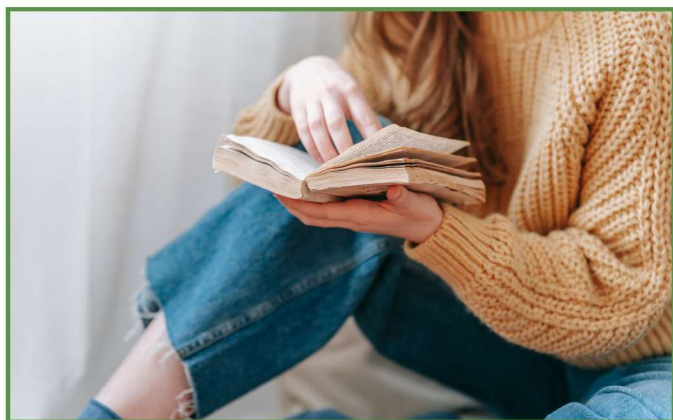
If you need a recent share count, check the company's latest 10-Q or 10-K, usually near the bottom of the cover page or just before the table of contents.

Use that figure when you need to come up with a market-capitalization or per-share number on your own. If a company is being bought and the parties don't immediately provide a per-share number for the purchase price, for example, you can estimate it – just divide the total purchase price by the number of shares.

WHEN TO SKIM, SEARCH AND TRULY READ

Quarterly and annual reports can be long. And companies can describe the same development in multiple places, with varying degrees of detail. If the report just came out and your goal is to spot any news that's in there, skim. It helps to understand in advance how the company organizes its quarterly reports and zero in on the most significant sections. Also take a look at sections relevant to any ongoing stories – that can mean the legal proceedings for a company facing lawsuits, for example.

If you're looking for something specific, control-F is your friend (or command-F on a Mac). If you find an interesting paragraph, search for some of its key terms or phrases. For example, searching for words such as "criminal" in a report can lead to some fascinating findings. You may just find more detail deeper in the report.



However, if you really just want to get to know a company better, don't rush. Read through sections of the report over time, taking a break to do something else in between, so your eyes don't glaze over. Ideally, you'll want to read the report with the most recent previous 10-Q or 10-K on hand so you can see how things have changed.



FOREIGN COMPANIES

If a company you're interested in isn't based in the U.S., but it trades on a U.S. exchange, it likely files a Form 20-F instead of a 10-K.

Paid filings services tend to include 20-Fs in the same search category as 10-Ks (along with 10-K/A filings, which are amended 10-Ks). Using EDGAR, however, you'll need to search specifically for 20-Fs, or filter a company's filing list using that code.

Some 20-F filers use the same accounting standards as U.S.-based companies, called U.S. Generally Accepted Accounting Principles (U.S. GAAP), but many report their financial statements under International Financial Reporting Standards (IFRS). Moreover, 20-Fs aren't required to include all the information typically found in a 10-K.

USEFUL GUIDES AND REFERENCES

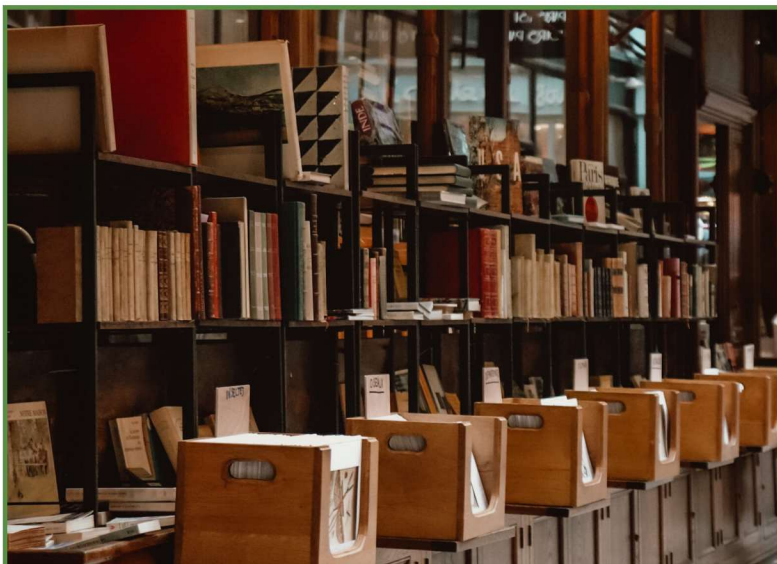
A number of websites offer tutorials or references on accounting and reading financial statements, starting with the SEC's website which offers an [overview](#) of the securities laws governing the 10-Q, 10-K, and other SEC filings.

[Investor.gov](#) is operated by the SEC's Office of Investor Education and Advocacy. They offer many financial resources including an overview of how to use EDGAR and a breakdown of all the sections of SEC filings.

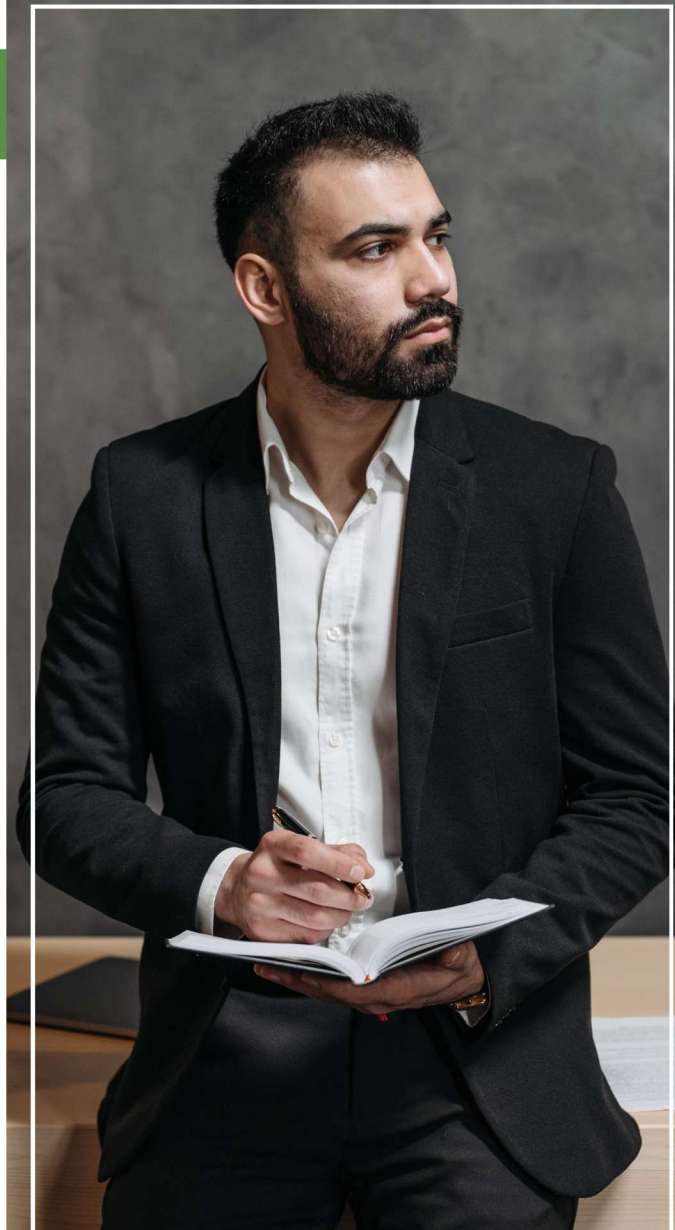
[AccountingCoach](#) is a very accessible website with multi-part explainers on the income statement, balance sheet, and more, as well as an accounting dictionary.

In addition to its extensive financial glossary available on Investopedia, this website offers a guide to reading an [earnings report](#), as well as an [introduction](#) to reading financial statements.

JournalistsResource.org offers a [thumbnail](#) sketch of what to look for in various SEC filings, and LexisNexis has a resource on [navigating different exhibit numbers](#).



This chapter is based on material originally written in 2013 for [businessjournalism.org](#) by Theo Francis, a financial and investigative reporter for The Wall Street Journal.



FIND EXPERTS

The SEC's [public affairs office](#) can help put you in touch with people able to answer technical questions about EDGAR, filings, and filing requirements. They tend to shy away from company-specific questions and some controversial issues.

Many major business law firms have securities-law experts who help companies draft their filings, and who can answer questions about them. Similarly, business and law schools at major universities generally have at least one professor who studies these issues. If you're stuck, it never hurts to reach out to an expert.