web-based reporting

a vision for the future

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Over the past five years, the Internet has crept into almost every facet of our lives. From airline schedules to zoo operating hours, anything you want to know is just a click away—or so it seems.

Today, more and more people are looking to the Internet as a source of business information. Individual investors are moving from traditional stockbroker services to Internet-based trading accounts. Sites such as Quicken.com, Yahoo! Finance, and The Motley Fool, as well as corporate websites, provide a wealth of online financial information for these investors. As both users and providers of this information, accountants can no longer afford to ignore the Internet as a reporting medium. In fact, participants in the AICPA's 2002 Top Technologies Forum considered business and financial reporting as the most important technological issue facing the accounting profession.

To determine the state of Web-based reporting, we tracked the corporate websites of the *Fortune* 100 at three points in time—June 1999, January 2001, and June 2003. Based on our observations, we believe that Web-based reporting will:

- Increase the frequency and quantity of both financial and nonfinancial information disclosure,
- Eventually be recognized as fulfilling Reg FD disclosure,
- Decrease paper-based communications costs,
- Result in new video and audio reporting practices, and
- Raise new legal issues.

INCREASED FREQUENCY OF DISCLOSURES

Historically, companies have communicated operations results with investors on a quarterly basis. But as former AICPA Chairman Robert Elliot testified before the Senate Committee on Banking, Housing, and Urban Affairs Subcommittee on Securities on July 19, 2000, ". . . the annual and quarterly reporting regime is not only on its way to becoming less and less useful, it is on its way to becoming a dinosaur, an organism that has outlived its environment." We agree.

Since business occurs more frequently than at quarter-end, why, then, doesn't financial reporting? With the Internet, it can. After all, investors now demand more frequent and timely information, such as real-time stock prices over the Internet.

Michael Young, a partner at the New York law firm of Willkie Farr & Gallagher and editor of the book *Accounting Irregularities and Financial Fraud*, pushes for real-time financial reporting. He says, "To some extent, implementation of a real-time financial reporting system would be almost remarkably straightforward. In its crudest form, it could simply involve the daily publication of revenue (or other available measure of financial performance) on a company's website." While implementation of a real-time reporting system isn't without problems, Young adds, "None of these barriers, however, should prove insurmountable."

Also, Section 409 of the Sarbanes-Oxley Act of 2002 requires real-time issuer disclosure. The requirement states that a business "shall disclose to the public on a rapid and current basis such additional information concerning material changes in the financial condition or operations of the issuer. . . which may include trend and qualitative information and graphic presentations." According to Young, this provision reflects the desire to move from the current periodic disclosure to a real-time disclosure for all relevant financial and nonfinancial information.

Some companies are already approaching real-time Web-based reporting. Take Cisco Systems, Inc. Known for closing its books in less than one day, the company posted its fiscal year 2003 third-quarter earnings on the Internet seven business days after the end of the quarter (http://newsroom.cisco.com/dlls/fin_050603.html). But this reporting practice still mirrors paper-based quarterly reporting. While its systems may provide for daily reporting, the company hasn't yet adopted that external reporting practice.

Other firms are moving slowly toward more frequent reporting. In the May 15, 2000, edition of *Investor Relations Business*, BP site coordinator David Bickerton said the company had redesigned its site: "The concept was to create a living report which would be regularly updated. We had long philosophical debates on real-time reporting. We couldn't start reporting in real-time straightaway, but it is closer than ever."

JCPenney and Amazon.com provide other examples. JCPenney reports monthly sales results on its website at http://www.jcpenney.net/company/finance/weekly.htm. Closer to real-time reporting, Amazon.com introduced "Delight-O-Meter" on its corporate website over the 2000 holiday season and has been using it every holiday season since. The Delight-O-Meter keeps a running count of the units customers order. While Amazon cautions against using the Delight-O-Meter as a financial indicator, analysts continue to make inferences based on the raw numbers.

INCREASED QUANTITY OF DISCLOSURE

There's already been a dramatic increase in the quantity of financial reporting via the Internet. Based on our observations in June 1999, January 2001, and June 2003, the percentage of companies providing their annual report on the website was 54.3%, 97.9%, and 100%, respectively. The average number of years of annual reports available online also increased to 1.98, 3.21, and 5.18 for the three points in time. Wal-Mart had the most annual reports available online as of June 2003 at 32. We also found similar trends for quarterly reports. This level of Web-based reporting isn't limited to large companies, as you can see if you tap into the Public Register's Annual Report Service, which boasts annual reports, prospectuses, or 10-Ks for more than 3,600 companies. You can visit the site at http://www.prars.com/.

While it's natural to expect that increased frequency of disclosure will result in more information, we predict an increase in the quantity of disclosure even if real-time reporting fails to materialize. Recent studies have found that the investing community desires additional disclosures—both financial and nonfinancial—in addition to the annual report, which discloses the financial results required by regulatory bodies. For instance, as reported in the April 1999 issue of *Strategic Finance*, a survey of star analysts found that more than 85% "said they would like more information on key business risks and uncertainties, financial liquidity and flexibility, the competitive strategy of the significant business units, and an identification of the corporate strategy."

In sync with the view of the star analysts, the AICPA's Special Committee on Financial Reporting (the "Jenkins Committee") focused on, among other things, the deficiency that exists in the nonfinancial information companies disclose. Disclosures of certain operating segments might not be required by the Financial Accounting Standards Board (FASB) and thus are left out of the annual report and 10-K. Yet the Internet provides the ideal medium for transmitting this nonregulated information. Intel, for instance, already discloses on its site changes in the price of Pentium® chips over the last month and highlights its expectation for earnings and profit margins in the upcoming quarter as well as its investments in new technology and other companies.

RECOGNIZED COMPLIANCE WITH REG FD

Posting information on a corporate website doesn't, by itself, constitute public disclosure, according to the Securities & Exchange Commission's Final Rule: *Selective Disclosure and Insider Trading* (Release No. 33-7881 at http://www.sec.gov). Yet we believe this will change. Right now, the primary means of disseminating information is through news wire releases that often appear in *The Wall Street Journal* or an SEC filing. The *Journal* reported a U.S. circulation of 1,890,041 as of March 31, 2003, but at the end of 2002, the Computer Industry Almanac, Inc. (http://www.c-i-a.com/pr1202.htm) estimated that there were more than 160 million Internet users in the U.S., and some have estimated there will be more than 35 million individual online trading accounts by the end of 2003, all requiring Internet access. These numbers clearly demonstrate the Net's greater potential for broad dissemination of information.

National Investor Relations Institute (NIRI) President Lou Thompson stated in the June 12, 2001, edition of *Investor Relations Business*, "We're not far away from the SEC allowing a Web-posted news release using push technology to alert individual investors and the media to constitute full and fair disclosure."

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Companies appear to be embracing Web-based reporting as a partial solution to Reg FD compliance, which requires companies to disclose information to the general public rather than to selected market professionals and investors in order to level the playing field between professional and individual investors. Reg FD was a prime motivator for Fannie Mae, the nation's largest source of financing for home mortgages, to go online with its financial information. "We have intense pressure to provide access to all investors," says Kyle Lynch, head of e-Investor Relations at Fannie Mae.

The director of investor relations at a large energy-related company echoes the same sentiment: "With new SEC rules (i.e., Reg FD), we envision investor relations websites becoming increasingly important in an effort to ensure all investors have equal and timely access to information." Some companies, such as Federal Express, even present their Reg FD policy online (http://www.fedex.com/us/investorrelations/financialinfo/disclosure.html.)

One Reg FD requirement is public access to conference calls with investment analysts. Internet webcasting provides a possible solution, as investors can log on and listen to the call. A June 2003 *Journal of Accountancy* article indicates that webcasts are gaining in popularity. The webcasts benefit the company in two ways. First, all information is immediately available to all interested parties, and, second, if sensitive or inappropriate information is inadvertently disclosed during the call, it's archived on the site and considered broadly disseminated.

DECREASED RELIANCE ON PAPER-BASED COMMUNICATIONS

With the cost of printing and mailing an annual report estimated to be $10 per copy, we believe that companies will replace paper-based investor communications with electronic versions.

Jayson Cottam of Amazon.com's investor relations department agrees, "There is both an economic and environmental advantage to maintaining information online. The information is readily accessible to people, and oftentimes there is no need to mail or print a paper copy of the information."

To a degree, it appears that companies are already taking advantage of this communication alternative. FedEx Corporation now relies heavily on Web-based reporting and has eliminated the automatic mailing of paper-based annual reports. If you want a report, you have to request it. According to annual report analyst Sid Cato, companies traditionally have printed about two annual report copies for every shareholder. With the development of Web-based reporting, that number has started to decrease.

According to SEC Release No. 33-7233, "the delivery of information through an electronic medium generally could satisfy delivery…under the federal securities laws." A company can send statements to stockholders through e-mail if (1) the investor consents to receiving the information in that manner, and (2) the company can prove an investor actually received the information. To satisfy these requirements, companies can solicit a shareholder's consent on the investor relations site, which IBM currently does, and can obtain either a return receipt on the e-mail or a confirmation e-mail from the investor signifying he/she received the documents.

MORE DATA FOR DOWNLOADING AND INVESTOR ANALYSIS

Information on a corporate website will become easier for investors to access and use because companies will provide data in a format that the end user can easily download into a spreadsheet and manipulate. Many of the *Fortune* 100 firms provide both traditional financial statement data and other operating data in a downloadable format. FedEx, for example, already provides consolidated financial statements in Excel format for the years 1998 to 2002. On the nonfinancial front, General Motors discloses monthly dealer delivery data and production schedules that can be downloaded into Excel for easy manipulation.

Further adoption of this practice likely will result from the continued development and adoption of XBRL (eXtensible Business Reporting Language) as the XML-based standard for Web-based presentation of financial reporting information. This electronic language will allow users to reliably extract information from various companies' financial statements and then conduct analyses.

USE OF NEW REPORTING MEDIA

As bandwidth increases, companies are making their sites more interactive with investors. Interactivity allows user feedback and introduces variation into delivery instead of employing static presentation in the form of HTML pages. This interactivity should transfer control of information to investors, allowing them to customize reports and manage what information they want to view.

As we mentioned earlier, companies already use Web technology to broadcast analyst conference calls, but future webcasts of annual stockholder meetings may be in real-time audio and even video.

Kevin Tarrant of Verizon says, "Who knows about the future? Maybe video with audio, virtual meetings, and things like videoconferencing to reduce the need to travel."

Changing reporting media may also affect how a company delivers its annual report. Companies can distribute a video presentation of the annual meeting, an audio message from the company's chairman, and customizable financial information—all through a website. With this technology, companies also have the ability to archive the audio and video presentations for those who couldn't tune in for the live webcast.

NEW LEGAL ISSUES

As companies adopt new methods of Web-based reporting, legal ramifications will arise. For one, companies should be careful about the hyperlinks included on their corporate websites. Providing a link to an analyst's report, for example, could be seen as "adopting" the views of that analyst. The SEC states in Release 33-7233, *Use of Electronic Media for Delivery Purposes*, "The direct and quick access to [an analyst's] research report would be similar to the company including the paper version of the research in the same envelope that it is using to mail the paper version." By providing information directly on the company's investor relations site, the company can increase its control over what investors download and decrease exposure to potential liabilities where investors assume the company's management is providing the information.

What about an auditor's legal liability with respect to information on the electronic site? According to AICPA's AU Section 9550, Interpretation of AU Section 550, "Other Information in Documents Containing Audited Financial Statements," auditors aren't currently required to read information contained in electronic sites or to consider the consistency of information. In addition, AU Section 550 doesn't address services related to the information on the website, so the AICPA left Web-based financial reporting totally unregulated. But according to a survey of its members by the Illinois CPA Society's Accounting and Assurance Services Network, most respondents believe a CPA should be responsible for the financial information in a report that's published electronically. It will only take a few shareholder lawsuits involving inconsistencies between Web-based and paper-based financial information before auditors must attest to management's online assertions.

RIDE THE WAVE

Predicting the future is always a risky venture, and you may not agree with what we forecast regarding Web-based reporting. But as we've already seen, investors and other interested parties are relying on the Internet for information delivery. Rather than being washed away by the growing wave of Web-based reporting, you need to think seriously about this practice and how it will play into your future reporting environment. ■

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