Financial Reporting on the Internet – Instant, Economical, Global Communication

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In countries with major capital markets, almost all large companies have Web sites and the majority of these sites include some form of financial reporting. Indeed, it is de rigueur that companies seeking to have markets beyond their national borders have a Web-based investor relations strategy because Web-based reports are instantly available to anyone in the world with an Internet connection. Since most companies already have Web sites, the incremental cost for this instantaneous, global reach is minimal.

Yet, while the advantages of the Web as a new mode of information dissemination are clear, financial reporting on the Web creates a number of challenges for companies and their auditors as well as for regulatory and standard-setting organizations. As such, it is no surprise that Web-based financial reporting has already drawn the attention of the international groups such as IFAC and IASC and major national regulatory organizations. In this brief article we discuss the variations we and other researchers have observed in financial reporting Web sites and the potential implications of those variations. We also canvass some recent developments in reporting on the Web, most notably XBRL, which is a major undertaking to develop financial reporting specifications for the digital world.

What are the rules?

Even a cursory exploration of financial reporting Web sites shows wide variations both in terms of the amount of content (e.g., summary financial statements vs. detailed financial statements) and style of presentation (e.g., similar to paper-based reports vs. inclusion of multimedia). There are also wide variations in how companies incorporate navigation aids (e.g., hypertext, search boxes, etc.) into their Web sites. Not all variations are necessarily undesirable since some experimentation is desirable in this early stage for establishing the future shape of reporting on the Internet. However, some of the observed variation could be potentially problematic for the quality of information provided to stakeholders.

The variations in reporting between companies are so wide that a user might be left with the impression that there are no rules for financial reporting on the Web. Depending on a person’s interpretation of current financial-reporting rules it is somewhat difficult to determine what exactly is allowed and what should be avoided when it comes to Web-based
reporting. In the United States, the Securities and Exchange Commission (SEC), in Securities Act Release No. 33-7233, indicates, in part, that, "The liability provisions of the federal securities laws apply equally to electronic and paper-based media." In other words, the Internet is just another media and the rules that apply to paper-based financial reporting equally apply to the Internet. By contrast, although the AICPA’s professional standards apply to auditing, its view of the Web provides an interesting different perspective. In Other information in documents containing audited financial statements: auditing and interpretations of Section 550 (AU 9550) paragraph 16 ends with the question "When audited financial statements and the independent auditor’s report thereon are included in an electronics site, what is the auditor’s responsibility with respect to other information included in the electronics site?" The answer, which appears in paragraph 17 states "Electronic sites are a means of distributing information and are not ‘documents,’ as that term is used in Section 550 ... Thus, auditors are not required by Section 550 to read information contained in electronics sites, or to consider the consistency of other information (as that term is used in Section 550) in an electronic sites with the original documents."

Research comparing firms’ Web financial disclosures to their paper based financial disclosures, reports that a large number of firms place only summary information on their Web sites. Since companies are not required to put any financial statements on their Web sites, it could be inferred that these companies may believe that their Web disclosures are meant to be additional, voluntary information and not as a substitute for their paper-based financial reports. However, we believe that companies should carefully consider their online disclosures in light of the SEC’s Securities Act Release No. 33-7233 (or their own country-specific rules) so as to ensure that their Web sites are not inadvertently violating existing financial reporting regulations.

What is a Financial Report?

One area of concern, particularly in light of the abovementioned SEC release, is the potential misuse of common financial reporting terminology. For example, on a significant number of Web sites there will be a link labelled, "Annual Report," however, in many cases, the link will take the user to a Web page whose content will be significantly different than the paper-based annual report. Sometimes the Web page will only include a summary income statement, a summary balance sheet, and a letter from the chairman of the board. For those companies that disclose less than their paper-based annual report, a frequently missing element is the notes to the financial statements.

These companies may argue that investors should recognize that these Web-based annual reports are summaries. This may be a big assumption. A growing number of new and inexperienced investors are using only Web sites for their investment research and subsequent placement of their investment orders. As such, they are not discussing their investments with human brokers or reviewing paper-based annual reports. While online brokerages are the most developed in the USA and Canada, the rapid growth of online brokerages is a worldwide phenomenon.
Available to Everybody?

Many companies who have summary disclosures on their Web sites frequently include downloadable versions of their annual reports in an Adobe Acrobat “Portable Document Format” (PDF) file. When downloaded and printed these files can provide an exact duplicate of the printed annual reports. However, to read or print these PDF files requires that the users download and install the Adobe Acrobat reader on their computers. Many people who are new to computers do not know how to do this. In addition, stakeholders who are accessing the Internet through various Internet specific appliances such as the WebTV or the new home Internet devices such as Compaq’s iPAQ do not have the capabilities of downloading and installing the Adobe Acrobat reader. Further, the size of these reports is typically very large. Annual reports are typically not less than 1.8MB and the largest we have seen was 60MB! Users with dial-up modems may well be discouraged to download the complete files.

What is GAAP?

Many corporations that do summarize their financial statements do include the auditor’s report. Generally, the only place in an annual report that indicates that the financial statements were completed in conformity with GAAP (or IASs, appropriate national accounting standards or relevant statutes of law) is in the auditor’s standard report (ISA 700 of IFAC standards)

The concern becomes what is the risk of associating at auditor’s report with less than complete annual report? Is the company who included the auditor’s report on the Web site at risk for implying that the summary financial disclosure is in accordance with GAAP? What is the auditor’s risk and responsibility? As stated previously, in the U.S. context, AU 9550 of the AICPA professional standards seems to relieve the auditor of any responsibility, but courts and juries may take a different view.

How were summary materials selected?

When summarizing their financial disclosure a company runs the risk of being accused of specifically including positive materials and excluding negative materials. For example, a somewhat disconcerting report by Ettredge, Richardson, and Scholz (1999) found that companies with qualified auditors’ opinions were less likely to include the auditor’s report on their Web sites then those with unqualified opinions. In a later study, Ettredge, Richardson, and Scholz (Forthcoming) also find evidence of selective dissemination of information on the Web by companies that received a going concern qualification.

Chapter 7--Legal and other issues identified--of the FASB report Electronic distribution of business reporting information has an interesting discussion related to selective disclosures. It is important to note that a company can be accused of improper disclosure by the omission of pertinent information. Therefore, when presenting summary information companies must be very careful in what they exclude from the presentation.
What are the Boundaries of the Annual Report?

When the investor has the paper-based annual report in their hands, they have a clear sense of the beginning and the end of the annual report. How those boundaries are indicated on Web sites is not clear. It is not unusual to have hyperlinks inside an annual report that takes the user outside the annual report—and almost never is there any warning to the user that they are leaving the annual report. Similarly, there are hyperlinks outside of the annual report that takes the user inside the annual report. Generally, the financial reports are included as a relatively small part of a company’s overall Web site that includes significant other materials. As such, it can be difficult for the user to know when they are inside or outside the annual report. The entire report may be a few pages within the investor relations Web pages, which in addition to the annual report, may include a wide variety of unaudited financial statements, forward looking financial information, as well as press releases and other IR materials. Unless the borders are clearly labelled, and usually they are not, a user of the financial Web site may misinterpret the scope of the auditor’s report that accompanies the financial statements.

For a growing number of companies, the Investor Relations pages will include either sound or video files (or at least transcripts) of the annual stockholders meeting. Since the Web pages with these files are close to (i.e., a click or two away from) the pages with the annual report, what is the risk that the users will believe that these files are within the scope of the annual report? What about the scope of the auditor’s report? What about other files of conference calls or analysts meetings conducted during the year? One of the concerns raised in the FASB report was the fact that these multimedia files rarely included any form of appropriate disclaimers.

Another "close-to" issue is links to Web sites of analysts who follow the company. What are risks here? Is the company tacitly agreeing with forward-looking statements on those analysts’ sites? Again, companies rarely included any form of appropriate disclaimers.

These border issues have implications for auditors. Companies are freely adding hyperlinks that links to the auditor’s report and they are creating hyperlinks inside the auditor’s report to pages (e.g., footnotes) included in the auditor’s report. Should companies be freely allowed to add hyperlinks to/from the auditor’s report? Who is at risk here?

Who are the End-Users?

A concern with the Web is the inherent nature of the Web—that is, information on a Web site is available to anyone, anyplace, at any time. When a company is designing its financial reporting Web site they may have a specific audience in mind such as a financial analysts. But unless the Web pages are protected by passwords, anyone could be using the information provided on the Web site. So, what if an unsophisticated investor uses the information on the Web site to make an investment decision, which they are subsequently unsatisfied with? Can the
company defend itself by saying that the Web site was not intended for unsophisticated investors? If companies want to avoid the situation, should they actually put some form of disclaimer on the Web site stating whom the intended audience is?

Code of Conduct

In a report for the IASC, prepared in 1999 along with colleagues, we recommended a set of common-sense best practices, or "Code of Conduct" for financial reporting on the Web. The 43 elements in the proposed Code are too long to reproduce in this article and interested readers should read or download the report at the IASC Web site. The issues we canvassed in the Code include multi-modal (Web and print) reporting, GAAP usage, completeness of data, languages, currency conversion, along with security, accessibility, site usability and links, both internal and external. For example, in respect of multi-modal reporting we recommended that:

Relationship of Web-based reports to reports in other forms: Where an enterprise is producing information in other forms such as in printed reports or in press releases, the enterprise should include on its Web site versions of its financial reports that include the information provided in those other forms. Information disclosed on the Web should not be contradictory to other versions of its published financial reports. If, for some reason, documents available online do not provide the full information from their original formats, the fact that information is missing should be clearly indicated, and a point of contact for obtaining this information should be provided. Conversely, if additional information is provided on the Web that is not provided in other formats, the fact that this is additional information should be disclosed.

And on the question of setting boundaries to the financial statements, the proposed Code states that:

Boundaries of IAS financial statements. The boundaries of the complete set of IAS financial statements should be clearly recognisable on an enterprise’s Web site, so that a user will know when he/she has moved out of the IAS financial statement area. IAS 1 provides guidance on identification of financial statements. The proposed Code of Conduct is currently under consideration by both the IASC and IFAC. While the report was prepared for the IASC, the guidance and the Code are generic and would, we imagine, apply to most reporting environments.

XBRL

Since, by definition, everything on the Web is in digital form, the Web could be viewed as one giant data warehouse where downloading and analyzing financial data should be relatively easy--at least easier than manually entering data from paper documents. Yet, for anyone who has tried to locate and download information from the Web knows, this is a very difficult task. The problem is that there is no underlying common language that will allow computers to uniquely identify financial-reporting elements on the Web page.
Requesting a search for something like "IBM AND Net Income AND 1999" will result in many thousands of potential links. We humans can actually deal with some of this ambiguity. From our experience with paper-based financial reports, we can probably recognize the official IBM Web site. But, for efficiency, we want computers to be able to do these searches automatically for us. Computers do not deal well with the current ambiguity. The search gets even more difficult to automate if the user tried to pose questions such as, "Compare the 1999 profit margins for Nokia and Ericsson" or "Give me the R&D expenses for the last five years for F Hoffman-La Roche Ltd." With current Web site technology these kinds of search are almost impossible to generalize.

Actually trying to download the information once it is found is also problematic. Let us assume that an analyst wished to obtain 20 financial statement values and two notes disclosure items over a five-year period for five companies in five countries. Currently they would need to go to the Web site for each company, find the annual report, download and print out if in PDF form or read on screen if in HTML and then re-key the information into a spreadsheet. Based on our experience of conducting such searches, this would take at least a half-day of work and probably more likely a day's work.

The promise of XBRL.org XBRL.org is to solve these data-identification problems. XBRL (eXtensible Business Reporting Language) is a multinational cooperative venture designed to produce an interoperable "financial reporting language of the Web." XBRL uses the XML Web mark-up language to provide a consistent means for companies to identify their financial and other information on the Web. The XBRL suite of specifications are designed to allow users to readily find financial reporting information on the Web and to then be able to extract values for sales, expenses, margin, assets and liabilities as well as the contents of the notes to the financial statements and other information. Users will also be aware of reporting currency, the GAAP under which the information was provided, and the reporting period. In other words, XBRL is designed as a major step toward to the Web-as-a-data-warehouse concept. XBRL is not a new form of accounting. It does not change GAAP. It does not resolve the issues of harmonization that we face in the accounting profession. What it does do is to make the financial information that companies elect to present more transparent and readily available to a global user community.

XBRL.org has grown from an initiative of the AICPA to include now more than 70 organizations including major national and international regulatory bodies, major accounting firms as well some progressive smaller public accounting firms, major software companies, and financial analysis and reporting organizations representing preparers, auditors, users and "middleware" communities.

XBRL specifications have been completed under U.S. GAAP for commercial and industrial organizations. Work is well advanced for a version of XBRL for commercial and industrial organizations for IAS GAAP and for other GAAPs and for other forms of entities such as governments and mutual funds. We urge you to visit www.XBRL.org and to sign up sign up for the XBRL email newsletter. More information will
be made available on XBRL in forthcoming issues of this newsletter.

As a closing comment on XBRL, it should be made clear that XBRL does not set standards on how much content or details that companies must include. Companies still individually decide what information to include on their financial reports. Once the companies decide what to include, adding the appropriate XBRL enhancements will greatly improve the visibility of that information to automated searches.

Conclusion

Since existing financial-reporting rules apparently applies equally to the Web, the wide range of variations observed in Web-based financial reporting would probably draw one to conclude that some companies are violating existing financial-reporting regulations. However, we surely do not want to discourage any company from Web-base reporting. We are suggesting that companies take a close look at what they are currently doing and make some adjustments (e.g., add "borders" to their annual reports, do not call the Web-based financial information an "annual report" unless it is as complete as the corresponding paper-based annual report) and/or add appropriate disclaimers.

It is also important that auditors and standard-setting organizations look at what the auditor’s roles and responsibilities should be. Maybe the standard-setting organizations may need to take a closer look at who owns the auditor’s report. Should clients have the level of freedom they currently seem to practice in terms of hyperlinking to/from the auditor’s report and placement of the auditor’s report in a borderless environment, with summary financial statements, and without appropriate disclaimers? It is one thing to not know how a client is inappropriately using the paper version of the auditor’s report, but it is a different thing when the whole world can see the auditor’s report on a client’s Web site.

Finally, we believe that at some point the regulatory organizations will have to consider the fact that the Web-based paradigm is so different than the paper-based paradigm--in terms of multimedia, hyperlinking, virtual space, interactivity, bit-based ethereal audit trials--that these organizations will have to specifically address Web-based reporting.

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Useful Web Sites
http://www.xbrl.org

Reading List

Available on the Web


Available in print


