IMPROVING BUSINESS REPORTING:

Insights into Enhancing Voluntary Disclosures

Steering Committee Report

Business Reporting Research Project

Business Reporting Research Project

This Report is one of three published sections of a broad study—the Business Reporting Research Project—sponsored by the FASB to determine, in selected industries, the kind of business information corporations are reporting outside of financial statements. A 14-person Steering Committee consisting of members of the Board's constituencies supervised the project.

In addition to eight industries studied, two separate studies complete the project. The first describes the electronic distribution of business information and casts a new light on the exciting possibilities and problems of the Internet and technology on the business reporting universe. The second deals with the redundancies between SEC and GAAP reporting requirements, thus pointing the way to eliminating overlap and duplication.

The Steering Committee wishes to thank the members of the five Working Groups involved in the study of voluntary disclosures (see the list of Working Group members starting on page 30) for their contributions to this Report.

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Former Chairman
American Stock Exchange
Former Chairman of FASAC

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This report is also available on the FASB web site at www.fasb.org.

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EXECUTIVE SUMMARY

The overall Business Reporting Research Project includes three separate studies. In addition to this study of voluntary disclosures of business information, separate studies address the electronic distribution of business information and redundancies between generally accepted accounting principles (GAAP) and Securities and Exchange Commission (SEC) disclosure requirements. This Executive Summary presents the Steering Committee's observations and recommendations about each of those studies.

Report on Voluntary Disclosures

The objective of this Report is to help companies (the preparer community) improve their business reporting by providing evidence that many leading companies are making extensive voluntary disclosures and by listing examples of those disclosures. The examples serve to provide companies with helpful ideas of how to describe and explain their investment potential to investors. The basic premise underlying this Business Reporting Research Project is that improving disclosures makes the capital allocation process more efficient and reduces the average cost of capital. The examples are not a list of recommended disclosures. They do illustrate, however, how companies are communicating with investors.

The term *voluntary disclosure*, as used in this Report, describes disclosures, primarily outside the financial statements, that are not explicitly required by GAAP or an SEC rule. However, the Steering Committee recognizes that many of these "voluntary disclosures" are made to comply with the SEC's requirements concerning description of a business and management's discussion and analysis of financial condition and results of operations (MD&A).

The Steering Committee thanks the companies who participated in the study for making their communications to the public easily available to the Working Groups.

Findings and Recommendations

- Many leading companies are voluntarily disclosing an extensive amount of business information that appears to be useful in communicating information to investors.
- The importance of voluntary disclosures is expected to increase in the future because of the fast pace of change in the business environment.
- Voluntary disclosures related to matters that are important to the success of individual companies are very useful, particularly disclosures of management's view of the company's "critical success factors" and trends surrounding those factors.

- Although some disclosures were found about unrecognized intangible assets, additional data about those assets would be beneficial because of the importance of intangibles to a company's value. Intangibles include not only those resulting from research and development but also human resources, customer relationships, innovations, and others.
- Although many examples were found of helpful disclosures of forward-looking information, there is room for significant broadening of this material.
- Voluntary disclosure should cover not only good news but also disappointments. Disclosures are most useful if they report on previously disclosed plans and goals and the results achieved in meeting those plans and goals.
- The metrics used by companies to manage their operations and drive their business strategies often are very useful voluntary disclosures. Those metrics should be explained and consistently disclosed from period to period to the extent they continue to be relevant to a company's success. However, a decision to make a voluntary disclosure in one period does not obligate a continuation of that disclosure if it is no longer relevant or if a better metric becomes available.
- Companies are encouraged to continue improving their business reporting and to experiment with the types of information disclosed and the manner by which it is disclosed.

Follow-up Activities

- Although each company is unique and must determine its own critical success factors and useful voluntary disclosures, the Business Reporting Research Project found it beneficial to study companies by industry. American Institute of Certified Public Accountants (AICPA) industry task forces and industry organizations are encouraged to study voluntary disclosure practices within their industries and to publish their findings and examples.
- More research is needed by the academic community and others about the relationship between informative disclosures and the cost of capital.

Report on Electronic Distribution of Business Information

This Report identifies present practices for the electronic distribution of business information and considers the implications of technology for business reporting in the future. Among the Report's highlights are identification of (a) leading-edge technologies as well as core features of corporate web sites; (b) divergent corporate strategic objectives and uses of the Internet; (c) notable present practices in terms of content and presentation; and (d) legal issues and questions related to web site practices. For people who would like to learn more about this research, the Report is available, at no cost, on the FASB web site at www.fasb.org.

The Steering Committee recommends that the FASB sponsor a similar study of electronic distribution practices in approximately two years, or earlier, because of the impact those practices have on the nature and content of business reporting.

Report on GAAP-SEC Disclosure Requirements

This Report identifies redundancies between GAAP and SEC disclosure requirements and ways to eliminate them. The Report also includes observations that the SEC is encouraged to consider in future rule-making activities. For people who would like to learn more about this research, the Report is available, at no cost, on the FASB web site at www.fasb.org.

The Steering Committee recommends that the Financial Accounting Standards Advisory Council (FASAC) be asked, in its advisory capacity, to monitor FASB and SEC progress in eliminating the redundancies. That could be accomplished by requesting the FASB chairman and the SEC representative to discuss progress on this matter in their reports to FASAC periodically.

The Steering Committee also recommends that the FASB staff and the SEC staff jointly adopt procedures to ensure that new redundancies do not arise in the future as is recommended in the Report. Finally, the Steering Committee recommends that the AICPA sponsor task forces to identify redundancies between GAAP and SEC disclosure requirements for certain specialized industries identified in the Report.

CHAPTER 1—INTRODUCTION

There are now some 12,000 publicly held companies in the United States, and we can expect that number to increase substantially in coming years. More people than ever are investing in public companies. And there is much more information about investments available and seemingly much less time in which to make judicious investment decisions.

Those developments are resulting in an environment that will increasingly demand that business reporting—the information that a company provides to help investors with capital allocation decisions about the company—be more reliable, relevant, and useful. Business reporting is more than financial statements; it includes a number of different elements such as operating data, performance measures, analysis of data, forward-looking information, and information about the company, its management and shareholders.

To that end, the Financial Accounting Standards Board (FASB) sponsored the Business Reporting Research Project. This project is a follow-on to the work of the AICPA Special Committee on Financial Reporting. The Special Committee was formed to address concerns about the relevance and usefulness of financial reporting. In 1994, the Special Committee issued its report, *Improving Business Reporting—A Customer Focus: Meeting the Information Needs of Investors and Creditors.* That report recommended improving the types of information included in business reporting and developed a comprehensive business reporting model indicating the types and timing of information that investors need to value and assess the risk of their investments. It also suggested that a study be made of information that companies voluntarily supply to users.

The organizational structure of the Business Reporting Research Project consisted of a Steering Committee and seven Working Groups. The Steering Committee guided, directed, and provided consultative advice to the Working Groups, which were responsible for the basic research or fact finding for the project. The Steering Committee and Working Groups included approximately 65 individuals from the FASB's constituencies who have extensive experience with and interest in business reporting.

Care was taken to ensure that a diversity of viewpoints is represented on the Steering Committee. Prominent on the Steering Committee are preparers and users of financial information (three each). Other members of the Steering Committee are an independent chairman, an investor relations executive, two academics, a lawyer, two auditors, an FASB Board member, and two observers from the SEC.

The members of the Steering Committee and their affiliations are:

Paul Kolton, *Chairman*
Former Chairman
American Stock Exchange
Former Chairman of FASAC

Joseph V. Anania
Board Member, Retired
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John K. Wulff
Chief Financial Officer,
Vice President, and Controller
Union Carbide Corporation

The representatives from the SEC staff who observed the Steering Committee meetings are:

John W. Albert
Associate Chief Accountant
Office of the Chief Accountant

Melanie F. Dolan
Associate Chief Accountant
Corporation Finance

E. Raymond Simpson, senior project manager at the FASB, provided staff support for the Steering Committee and Working Groups.

The objective of this Report is to help companies improve their business reporting. By providing evidence that many leading companies are making extensive voluntary disclosures and by listing examples of those disclosures, the Steering Committee expects that more companies will undertake or expand their efforts of providing voluntary disclosures. The examples in this Report provide helpful illustrations of such voluntary disclosures. They do not present a list of recommended disclosures. Individual companies will need to determine their own appropriate, relevant, and useful voluntary disclosures.

Five Working Groups identified present practices in eight industries for the voluntary disclosure of useful business information. The Working Groups presented their findings in a series of meetings with the Steering Committee.

Each of the Working Groups had a chairperson and one preparer, user, academic, auditor, and FASB Board member. The preparer, user, and auditor each had significant experience working in the particular industry studied and thus provided expert industry knowledge that assisted and enhanced the Working Group's activities.

Chapter 2 and Appendix C present the detailed findings of the Working Groups. Appendix A identifies the participants in the Working Groups and the companies examined.

Companies that make voluntary disclosures have chosen to differentiate themselves by enhancing the amount of business information they provide. Effective voluntary disclosures can provide more transparency and understanding about the company to investors and creditors. Generally speaking, informative disclosures help investors better understand a company's strategy (including how it addresses opportunities and risks); critical success factors that are important to the company's future; the competitive environment within which the company operates and the framework within which decisions are made; and the steps the company is taking to ensure sustainable results. Chapter 3 discusses a basic framework for providing voluntary disclosures.

A critical assessment for many companies in determining what to report voluntarily is whether certain disclosures might create a competitive disadvantage for the company. Chapter 4 discusses the competitive aspect of voluntary disclosure issues.

Because of the apparent ever-increasing rate of change, the Steering Committee believes that voluntary disclosures will increase in importance in the future. Chapter 5 provides a view of key forces shaping the future for business reporting.

CHAPTER 2—VOLUNTARY DISCLOSURE OF BUSINESS INFORMATION

Introduction

The Steering Committee guided and directed the activities of five Working Groups that identified present practices for the voluntary disclosure of business information in eight industries. The Working Groups' primary focus was to identify voluntary disclosures believed to be especially helpful to investors for making investment decisions. Detailed findings are presented in Appendix C.

For this Report, the term *voluntary disclosure* describes disclosures, primarily outside the financial statements, that is not explicitly required by GAAP or an SEC rule. However, it is recognized that many of these "voluntary disclosures" are made to comply with the SEC's requirements concerning description of a business and management's discussion and analysis of financial condition and results of operations. The Steering Committee did not believe that a debate about the degree to which some disclosures are already required would be useful to this process and, instead, focused on the primary objective of identifying disclosures believed to be especially helpful for investors.

Six to nine large companies (their names are in Appendix A) were studied in each of the following industries:

Automobiles	Oil—Integrated Domestic
Chemicals	Pharmaceuticals
Computer Systems	Regional Banks
Foods	Textile—Apparel

Working Group members reviewed company-supplied copies of materials such as annual and quarterly reports, SEC filings, press releases, fact books, and transcripts of presentations to shareholders, analysts, and potential investors. All materials reviewed by the Working Groups were material the companies had made available to the public. Companies' web sites also were reviewed.

For each industry, voluntary disclosures of business information are classified within the following six categories. The first five categories are those included in the AICPA Special Committee on Financial Reporting's comprehensive business reporting model. The sixth category pertaining to intangible assets was added because intangible assets are considered to be of increasing importance to companies and investors today.

Business data (for example, high-level operating data and performance measurements that management uses to manage the business)

Management's analysis of business data (for example, reasons for changes in the operating and performance-related data, and the identity and past effect of key trends)

Forward-looking information (for example, opportunities and risks including those resulting from key trends; management's plans, including critical success factors; and comparison of actual business performance to previously disclosed opportunities, risks, and management's plans)

Information about management and shareholders (for example, directors, management, compensation, major shareholders, and transactions and relationships among related parties)

Background about the company (for example, broad objectives and strategies, scope and description of business and properties, and impact of industry structure on the company)

Information about intangible assets that have not been recognized in the financial statements.

Set forth below, for each of those categories of business information, are some examples taken from the detailed findings in Appendix C. (The examples for each category are subdivided between information about *sales, products*, *operations*, and *financial performance.*)

Business Data

Examples of business data disclosed about *sales* are:

- Details of growth in market share in all major regions and countries (Automobiles)*
- Table of monthly orders broken down by strategic business unit and by product category (Computer Systems)
- Information about the company's sales and marketing teams, including number of experienced professionals, backgrounds, sales force productivity, and image (Pharmaceuticals)
- Discussion of change in approach to an important overseas region's sales strategy (Foods).

*The company's industry is identified in parentheses.

Examples of business data disclosed about *products* are:

- Information about the rollout of new products and the expansion of high-growth product lines (Computer Systems)
- Quarterly changes in physical volume of product by business group and by geographic location of customer, expressed as percentages (Chemicals)
- Description of products in development and product agreements with strategic alliance partners (Pharmaceuticals)
- The number of physicians prescribing specific products, the total number of prescriptions written for specific products, and the number of patients currently being prescribed for specific products (Pharmaceuticals).

Examples of business data disclosed about *operations* are:

- Quarterly capacity utilization of production facilities (Automobiles)
- Plant capacities by product, including the past year's additions to those capacities and the additions scheduled for the upcoming year (Chemicals)
- Productivity gains over several years in terms of sales per employee and earnings before interest and taxes (EBIT) per employee (Chemicals)
- Initial production rates from new fields and test flow rates for new exploration wells (Oil—Integrated Domestic)
- Discussion of expanded presence in international locations through joint ventures (Food)
- Description of labor contracts in the United States and Europe (Automobiles)
- The percentage of garments sewn offshore (Textile—Apparel)
- The reduction in full-time employees during the year and the number of full-time equivalent employees at year-end (Regional Banks)
- The percentage of noninterest operating costs "taken out" after integration of the operations of new acquisitions (Regional Banks).

Examples of business data disclosed about *financial performance* are:

- Graph depicting the resiliency of earnings per share to price changes over several years that demonstrates the company's ability to maintain earnings in the face of price volatility (Chemicals)
- Company's percentage return on invested capital compared with that of the industry, and information about stock price performance as compared with certain competitors (Computer Systems)
- A good discussion of actions taken and expected outcomes by a company in a financial "turnaround" situation (Computer Systems).

Management's Analysis of Business Data

Examples of management's analysis of business data about *sales* are:

- Analysis of the automobile marketplace in each major region or country (Automobiles)
- Quarterly analysis of volume, price, and cost trends by segment (Chemicals)
- Discussion of the impact of generic drugs in the marketplace and their effect on specific brand name product sales (Pharmaceuticals)
- Discussion of the impact of market conditions on sales volume and product pricing (Pharmaceuticals)
- Disclosure of the effect on fee revenue if equity values increase or decrease 10 percent and if bond prices increase or decrease 10 percent (Regional Banks).

Examples of management's analysis of business data about *products* are:

- Disclosure of the company's goal for the percentage of revenue from products introduced within the last three years together with a five-year chart on revenues from products introduced in the last three years (Computer Systems)
- Summary of consumers' level of concern about specific health matters pertaining to food (Foods)
- Disclosure of the company's domestic market share of various product lines with comparisons to competitors (Textile—Apparel).

Examples of management's analysis of business data about *operations* are:

- Detailed information about the impact of strikes (Automobiles)
- Discussion of the impact of technology on research and development (R&D) expenditures and product research (Pharmaceuticals)
- Presentation of historical information demonstrating trends in raw material prices (Foods).

Examples of management's analysis of business data about *financial performance* are:

- Discussion, by regions, of the year's highlights and accomplishments, management responses to business climates, investments in capacity and in partnerships, earnings trends, liquidity review, and strategic position (Automobiles)
- The company's performance (benchmarked against many of its peer companies) for revenue growth, earnings growth, cash flow, return on equity (ROE), and total shareholder return (Computer Systems)
- Sensitivity of operating profit, earnings, cash flow, and earnings per share (EPS) to changes in the unit price of a major chemical product, refined product, crude oil, and natural gas (Oil—Integrated Domestic)

- Key performance measures for the company as compared with the 25 largest banks about assets, net income, return on assets (ROA), ROE, equity/assets, nonperforming assets, loan loss coverage information, overhead ratio, and Standard and Poor's (S&P), credit ratings (Regional Banks).

Forward-Looking Information

Examples of forward-looking information disclosed about *sales* are:

- Forecast of unit sales for the coming year in each major country (Automobiles)
- Discussion of the growth opportunities in the company's four major customer categories (Computer Systems).

Examples of forward-looking information disclosed about *products* are:

- Discussion of a product whose patent protection will expire and the potential impact on the product's revenue stream (Pharmaceuticals)
- Plans for expansion and particular brand introductions into specific international regions (Food).

Examples of forward-looking information disclosed about future *operations* are:

- Next year's targets for growth in revenues, net income, and gross margin and for reducing the ratio of expenses to revenues (Computer Systems)
- Five-year projections of reserve additions and lifting costs by region (Oil—Integrated Domestic)
- Projected cash flow, oil production, and gas sales for five years (Oil—Integrated Domestic)
- Report on the company's effectiveness during the past year in meeting its beginning-of-year performance targets, which included vehicle unit sales, sales and revenues, net income, and capital expenditures (Automobiles)
- Management discussion of projects and previous years' goals and milestones, those not achieved and those to be deferred to future periods (Oil—Integrated Domestic).

Examples of forward-looking information disclosed about *financial performance* are:

- Projected earnings and free cash flows by segment (Chemicals)
- Projected five-year earnings growth for the company versus peers (Regional Banks)
- Percentage growth goals for revenue, EPS, and ROE by line of business for two years (Regional Banks).

Information about Management and Shareholders

Disclosures for this category included in the detailed findings (Appendix C) prove interesting but do not go significantly beyond what is currently required or generally provided.

Background about the Company

An example of background information disclosed about *sales* is:

- Discussion of legislation in the industry regarding the mandatory use of generic drugs (Pharmaceuticals).

Examples of background information disclosed about *products* are:

- Description of the company's products and their uses (Chemicals)
- Discussion of trends in the industry and their potential impact on the company's current and planned product lines (Pharmaceuticals)
- Detailed listing of products, brands, and registered trademarks (Food).

Examples of background information disclosed about *operations* are:

- Principal manufacturing facilities and the products manufactured and the number of employees (Automobiles)
- Discussion of the company's strategy to control operating expenses and the strategy for spending on R&D (Computer Systems)
- Discussion of the company's transition from a country-based management approach to a strategic-lines-of-business management approach (Computer Systems)
- Description of the company's long-term performance objectives (Food).

An example of background information disclosed about *financial performance* is:

- Description of the company's strategy for acquisitions (Regional Banks).

Information about Unrecognized Intangible Assets

Accounting standards prohibit recognition of intangible assets in many instances. However, accounting prohibitions do not obviate the existence of those intangible assets or the fact that intangible assets are critical to the success of some businesses. Disclosure of information about unrecognized intangible assets such as research and development, human resources, customer relations, innovations, and others that are critical to the success of a business would be especially helpful to investors in making investment decisions.

The detailed findings (Appendix C) show that companies in the pharmaceutical industry made considerable disclosures about their research and development activities and product development pipeline. Disclosures by companies in other industries were generally sparse. The few disclosures found tended to be somewhat vague and not particularly helpful.

One explanation may be that companies in the pharmaceutical industry recognize that information about research and development activities and the product development pipeline is one of their key performance measurements and that investors need it to assess management's plans and strategies. Other industries for which product development is also very important, such as computer systems, may disclose less because they concluded that the benefit of voluntary disclosures in this area does not outweigh the risk of competitive disadvantage.

CHAPTER 3—FRAMEWORK FOR PROVIDING VOLUNTARY DISCLOSURES

Introduction

The Steering Committee found that some leading companies are voluntarily disclosing an extensive amount of what appears to be useful business information, and the Steering Committee encourages companies to continue improving their business reporting and to experiment with the types of information disclosed and the manner by which it is disclosed. In this regard, the Steering Committee considered what guidance it could provide to assist management in identifying additional disclosures that would help current and potential investors assess opportunities to invest in that company.

Most people would agree that many of the examples of voluntary disclosures in Chapter 2 deal with business information that would be particularly useful to investors for making investment decisions. Their usefulness is intuitively obvious.

Relying on intuition, however, is not the best way to make decisions about voluntary disclosures. For that reason, the Steering Committee developed a basic *framework for providing voluntary disclosures,* that is, a process for (a) identifying information that would be helpful to investors and (b) deciding whether disclosure would be appropriate.

The Steering Committee's framework for providing voluntary disclosures follows:

- Identify the aspects of the company's business that are especially important to the company's success. These are the critical success factors for the company.
- Identify management's strategies and plans for managing those critical success factors in the past and going forward.
- Identify metrics (operating data performance measures) used by management to measure and manage the implementation of their strategies and plans.
- Consider whether voluntary disclosures about the company's forward-looking strategies and plans and metrics would adversely affect the company's competitive position and whether the risk of adversely affecting competitive position exceeds the expected benefit of making the voluntary disclosure.
- If disclosure is deemed appropriate, determine how best to voluntarily present that information. The nature of metrics presented should be explained, and those metrics should be consistently disclosed from period to period to the extent they continue to be relevant.

Each of the procedures in the Steering Committee's framework for providing voluntary disclosures is discussed in more detail below.

Important Aspects of the Business

The first step is to identify the aspects of a company's business that are especially important to its success. Every aspect of a business is, of course, important, and none can be ignored. But, usually, a handful of activities are overridingly important to the success of a particular company. Hence, information about the critical success factors for the business will be especially useful to investors. Although similar critical success factors may be found for different companies and may also be similar within certain industries, the factors are company-specific.

Among industries studied in this project, for example, research and development activities appear to be an important factor for companies in the pharmaceutical industry, and cost containment is important for companies that manufacture and sell commodity chemicals. Business activities related to sales and revenues, products and brands, and capacity and operating efficiency are examples of factors that appear to rank high in importance to the success of companies in many of the industries studied. Information about these types of activities is expected to be important to investors in making investment decisions.

However, the Steering Committee's effort was not designed to determine a definitive list of the important aspects of the businesses of companies in any particular industry. That would be impossible because all companies in a particular industry are not alike. Also, an aspect of the business that management of one company considers important might not be viewed the same way by management of another company in the same industry. And companies within an industry often compete with each other by employing different strategies. In summary, each company is unique, and a one-size-fits-all approach will not work for companies in any industry. Therefore, management of each company needs to determine the aspects of its business that are important to its success based on that management's view of the business.

Useful voluntary disclosures relate to matters that are important to the success of individual companies. Companies should disclose their critical success factors and focus their disclosures on those factors.

Management's Strategies and Plans

The next step is to identify management's strategies and plans for managing those aspects of the business that are especially important to the company's success. Disclosure of management's strategies informs investors about where management intends to take the company. Disclosure of management's plans informs investors about how management expects to get there. Information about management's strategies and plans is particularly important to investors in making investment decisions because the quality of those strategies and plans and management's effectiveness in executing them will be major factors in determining the company's success.

Metrics

Metrics (operating data and performance measures) measure things such as market share, operating efficiency, strength of vendor-customer relationships, employee satisfaction, and also the rate of change in those measures. Management uses many different measurements to track a company's performance, to monitor incentives, and to generally manage the business. For example, performance measurements are used to assess how effectively management's strategies and plans are implemented.

Voluntary disclosures that cover not only good news but also disappointments enhance a company's credibility. Disclosures of metrics comparing actual performance with previously disclosed management's goals, strategies, and plans help investors to identify and quantify both successes and disappointments.

Aspects of the business that are deemed important are managed, and things that are managed get measured. Investors want to see a company through the eyes of management, and to some extent that occurs if investors can study the same metrics that management uses and thereby understand how effectively established goals are being met.

Competitive Disadvantage

Management needs to consider whether disclosures about a company's forward-looking strategies and plans and metrics and other information would adversely affect the company by aiding its competition or by creating a bargaining disadvantage with suppliers, customers, or employees.

The Steering Committee accepts the conclusion that a company will decide not to make some voluntary disclosures when it concludes that the risk of competitive harm outweighs the expected benefit from making the voluntary disclosure. However, the Steering Committee also observes that a company should not use competitive harm as an excuse to avoid providing required disclosures. The competitive aspect of disclosure issues is discussed in more detail in Chapter 4.

Voluntary Disclosures

The Steering Committee encourages companies to expand their voluntary disclosures of information useful to investors in making investment decisions. The metrics used by companies to manage their operations and drive their business strategies usually are the most useful voluntary disclosures. These performance measurements should be explained and consistently disclosed from period to period to the extent they continue to be relevant. However, a decision to make a voluntary disclosure in one period does not obligate a continuation of making that disclosure if it is no longer relevant or if a more relevant metric becomes available.

A basic premise upon which this project is based is that improving disclosures makes the capital allocation process more efficient and the average cost of capital lower. Appendix B presents synopses of three research studies of informative disclosures and the cost of capital. The Steering Committee believes that additional research in this area by the academic community and others is needed.

The constant need for capital is one reason why management needs to do an effective job in explaining their company to investors. For example, an observation of the Working Group that studied companies in the chemical industry is that there has been a significant increase in the quality of voluntary disclosures over the last five years. The reason is competition—competition for capital. After one company provides a particular disclosure requested by investors, competitive pressure causes other companies to follow suit.

A company's cost of capital is believed to include a premium for investors' uncertainty about the adequacy and accuracy of the information available about the company. To cite an extreme example, if a company disclosed *nothing,* its cost of capital, if any was available, would be very expensive. Informative disclosures that help investors interpret companies' economic prospects are believed to reduce the cost of capital.

CHAPTER 4—THE COMPETITIVE ASPECT OF VOLUNTARY DISCLOSURE ISSUES*

Improving the types of voluntary information included in business reporting inevitably means facing difficult cost-benefit decisions. Unfortunately, definitive quantification of benefits and costs is impossible.

Main Benefits and Costs of Informative Voluntary Disclosures

The *main potential benefits* of informative voluntary disclosures are believed to be:

Investors benefit from the reduced likelihood that they will misallocate their capital. Companies (and their owners) benefit from:

- A lower average cost of capital
- Enhanced credibility and improved investor relations
- Access to more liquid markets with narrower price changes between transactions
- The likelihood that they will make better investment decisions (as users of other companies' financial statements)
- Lesser danger of litigation alleging inadequate informative disclosure and better defenses when such suits are brought.

The general economy benefits from:

- More effective allocation of capital
- The investment effect of a lower cost of capital
- More liquid capital markets.

The *main potential costs* of informative voluntary disclosures are believed to be:

Companies (and their owners) bear the costs of:

- Competitive disadvantage from their informative disclosure
- Bargaining disadvantage from their disclosure to suppliers, customers, and employees
- Litigation from meritless suits attributable to informative disclosure.

*Discussion in this Report about the competitive aspect of disclosure issues pertains to *voluntary* disclosures and not to disclosures required by GAAP or the SEC.

The general economy bears the costs of:

- Developing, presenting, understanding, and analyzing informative disclosure
- The drag on growth from meritless suits attributable to informative disclosure.

Factors That Determine Competitive Disadvantage

Three factors appear to determine whether information creates competitive disadvantage: the *type* of information, the *level of detail*, and the *timing* of the disclosure. As for the type of information, routine operating data (companies often provide such operating data for inclusion in industry-wide statistics) are generally less likely to cause competitive disadvantage than information about product development. However, the greater the level of detail about new product plans—for example, including unique features and the reasons for their potential appeal—the greater the likelihood of competitive disadvantage. Similarly, the level of detail about other types of disclosures determines whether they can cause competitive disadvantage.

The timing of a disclosure also affects its potential for competitive disadvantage because at some stage disclosure loses its capacity to create competitive disadvantage. Strategies become obvious from actions, and information about them then no longer leads to competitive disadvantage. Products in development eventually come to market, and the closer to that date that product plans are disclosed, the less time there is for a competitor to respond.

The Difficulty of Generalizations

Even with awareness of the factors just cited, it is difficult to generalize or be certain about the effect of particular disclosures on competitiveness. For example, a potential competitor evaluating the investment hurdle to enter an industry might as likely be dissuaded by the disclosures as encouraged to enter the field.

There is also disclosure behavior that runs counter to the often intuitive notion of competitive disadvantage. New products, for example, sometimes are announced early in order to convince competitors that the market has been preempted or to give the product a head start in name recognition. Announcements of new products and planned products are also a form of public relations, keeping a corporate name associated with progress in the public mind. Finally, new product plans often are revealed to users in order to keep or win their support.

Judgment Is Needed

Competitive disadvantage is a difficult issue that was not a focus of the Report, but the Steering Committee accepts the fact that companies need to make difficult cost-benefit decisions when determining how much voluntary disclosure is appropriate. Deciding which disclosures would harm competitive position requires judgment. What is not harmful for one company may be damaging for another. Or what is harmful at one point in time may not be harmful if disclosed later. It is not possible to specify that disclosure of certain types of information is always harmful—the issue depends on the particular facts and circumstances. Thus, it is necessary for management, which is closest to the business, to decide which specific disclosures would be harmful and which would not.

In any case, the ability to limit disclosures of competitively sensitive information should not be used as an excuse to avoid making required disclosures.

Competitors Sometimes Already Know

Competitors sometimes already know a great deal about a company from the company's former employees, mutual suppliers and customers, market research, industry publications, dismantlement and engineering studies of competitors' products, and the marketplace itself. The competitive cost of disclosing information thus depends on the incremental insight that information brings to competitors relative to the competitors' other sources of intelligence.

Repackaging Information to Prevent Competitive Harm

Even information that could harm a company's competitive position often can be repackaged in a form that is not harmful while still proving helpful to users. For example, companies can discuss issues at a higher level than the amount of detail that would provide competitors with specifically harmful information.

Disclosure of a company's plans to market a new type of product and the reasons why management believes the product will be successful may alert competitors prematurely and cause them to accelerate their own development plans thereby creating competitive harm. But companies can delay disclosure of such information until it no longer proves harmful. Before that point, the company could release general information about its product-development function—such as its historical ability to be first to market with innovative and successful products, and the trend in the company's product-development lead time.

Summary

It is impossible to measure many of the costs and benefits of improved voluntary disclosures, including the cost of disclosing possibly competitively harmful information or the benefits to investors, companies, and the economy of another piece of useful information. Nevertheless, cost-benefit decisions must be made as carefully as possible, and many of the above considerations should be factored into those decisions.

CHAPTER 5—KEY FORCES SHAPING THE FUTURE FOR BUSINESS REPORTING

As we move into the 21st century, voluntary disclosure as currently done may well be affected by the fact that the business environment is changing dramatically, and at an accelerating pace. These rapid changes, some of them massive in nature, will manifest themselves in increasing and changing demands for business information and a larger role for voluntary disclosures. Accompanying this will be an increasing ability to supply more information. In addition, the existing regulatory and standard-setting systems will in all likelihood struggle to keep up with the changes.

The forces detailed below are among those that are believed to be reshaping the business environment. These and other related forces will continue to have an effect for the foreseeable future. One result will certainly be a demand for more thorough and reliable disclosure of information that will be helpful to investors in an increasingly complex and confusing marketplace. Among the key forces the Steering Committee discussed that may be transforming the business environment are:

Economic Factors

Included here are such factors as:

- *Globalization.* There continues to be a powerful shift in business from local and national to international, including cross-border capital formation and the globalization of finance. A financial model based on transparency, accountability, and regulation is gradually being adopted around the world. It is accompanied by a shift from inside (patient) capital to outside (impatient) capital, with correspondingly stronger pressures for performance and responsiveness.
- *The Democratization of Ownership*. Over 50 percent of American families now own stock, either directly or indirectly, through holdings in mutual funds, 401(k)s, and so forth. Additionally, many American workers, by some estimates as much as 10 percent, now receive stock options. A more universal capitalism, spurred by the virtual disappearance of Marxism and the shift to market economies almost everywhere, has arrived. The rapid growth of middle classes around the world means that what is now happening in the United States will probably occur elsewhere around the world.
- *Competition.* Technology is a great enabler. It makes it relatively easy and inexpensive for new businesses to begin. This is a major contributor to the immense increase in competitiveness in business. A great upsurge in entrepreneurship also is a factor. Indications are that as more people around the world have more disposable income, competition will increase. The value of a brand becomes greater as a provider of a competitive advantage. On the other hand, there is a significant decline in consumer loyalty to products and companies.

- *Focus on Wealth Creation.* There are now over five million millionaires in the United States. Starting one's own business is increasing in popularity. More and more people are beginning to believe that it may be possible for them to accumulate wealth, and this mindset shift may be a profound and lasting one. This will be accompanied—and accelerated—by a rapidly growing worldwide middle class that may well reach two-and-one-half billion people by 2010.
- *Changes in the Nature of Business Assets.* The important assets of enterprises are increasingly intangible. There is general agreement among business observers and analysts that the big contributors to business success are a company's people, its customers, its knowledge base, and its reputation. These are largely unquantifiable. Indeed, *Business Week,* in a special issue on "The 21st Century Corporation," August 28, 2000, says that "human capital is the only asset."

Technological Factors

There are two very great contributors here:

- *The Computer Revolution.* This is resulting in a continuing and almost stunning decline in the cost of information and a dramatic increase in productivity for both businesses and investors. The computer is also radically altering the structures of organizations and the nature of relationships within them.
- *The Internet.* How business is done will increasingly be affected by the rapid spread of the Internet. One key point: Internet business now is formed on two main themes: (a) new ways of business-to-business dealing and (b) controlling access to consumers, for example, creating a right of way that will be a significant business asset in the future.

Another factor to consider is the importance of making the correct choice in technology. As businesses are faced with choosing between emerging technologies, these decisions become critical to financial well-being. Because investments in technology can be so massive, the adverse effects of backing the wrong technology can be immense.

Social Factors

- *Change in the Nature or Locus of Authority.* Democratization, the declining ability to have centralized control of information, is profoundly changing the nature of our society. Disintermediation, the shift from traditional to alternative suppliers and businesses, eroded the authority of everyone from big financial institutions to doctors. New manifestations of authority appear increasingly to be based on a model that is decentralized, uncredentialed, and based not on experts but on the accumulated experiences of customers.

- *Decline of Trust.* Surveys consistently show that a more educated public, with much more information available to it and bombarded by media increasingly focused on sensationalism and exposure, is much less trustful than it used to be. Cynicism and skepticism are at all-time high levels, helping to create a declining respect for authority. The Internet generates more opportunity for rumors and disinformation to circulate.
- *Litigiousness.* A more aggressive public will continue to seek redress for grievances and perceived misconduct in the courts.
- *The Need for Intermediaries.* The overabundance of information will make it increasingly difficult for even sophisticated investors to make good decisions. Trustworthy intermediaries who can validate both information and the sources of it will become increasingly necessary.
- *Value Shifts.* The American people, never particularly noted for submissiveness, are increasingly feeling empowered. As consumers, as employees, as voters, and as shareholders, they are more demanding that their rights be respected and that they be treated fairly.
- *Time Pressures.* The greatly increased complexity of modern life, exacerbated by the accelerating pace of change, is making people impatient with an overabundance of information.
- *Stewardship.* Businesses increasingly are being asked to exercise social responsibilities, contributing more to the well-being of their workers, their customers, and their communities.

Government and Political Factors

- *Philosophical Shifts.* The idea that competition is the best regulator has gained adherents even on what used to be the left side of the political spectrum. More regulation focused on enhancing competition seems likely. Additionally, a growing awareness in governments around the world that innovation is the key to national economic success will mean that more regulation and legislation will be directed at nurturing innovation.
- *The Nanny State.* With the decline of national government power in some areas (for example, control over value of the country's currency), governments are moving into other areas. For example, there is the rise of what some have called the Nanny State—a government that focuses on what's best for its citizens, such as what they should or should not eat, drink, and smoke.
- *Focus on Human Rights.* More governments seem more willing to put more pressure on businesses to help bring about and enforce global standards for workers' rights, children's rights, and women's rights.

Organizational Shifts

In response to all of these, and many other factors, businesses are adapting by changing their structures and behaviors in significant ways. Mergers and acquisitions are creating both behemoths and multifaceted, multitasked organizations. Technology is enabling the formation of the *virtual organization,* one that changes its structure and nature to meet different challenges and opportunities. Technology will also continue to create organizations that exist in both cyberspace and the real world. Alliances, temporary and permanent, will make it increasingly difficult to differentiate among friends and foes. Outsourcing and the use of temporary, part-time, and contract workers will in all likelihood continue at least at the present rate. The rapidly spreading shift to performance-linked compensation is changing relationships within organizations. The great increase in use of stock options is an example.

Summary

All the forces mentioned are expected to result in significant challenges to business reporting, including:

- Globalization and the spread of ownership will obviously result in larger audiences for business information. Some will be more sophisticated and many less so, and there will be a greater international component. There will also be more and different investment styles to take into account. And technology will mean that more information—and more sources of information—about companies will be available to people, many of whom will not be equipped to judge the quality and validity of what they see.
- Changing times will result in different factors becoming more critical to financial success. For example, intangibles will become more important, as will technology. The difficulty of measuring some of these factors will be affected by, and will affect, the trust level of investors. This, in turn, will affect litigation.
- There will be considerably more competition, not just for capital, but for people and resources. Capital markets may well become more volatile and unpredictable. Consequently, a company's reputation may become an even more significant factor in how well it succeeds in competing for both people and capital.
- The shift of power away from central authorities, combined with the overabundance of information, will create a need for better, more timely, and more precisely targeted business information.
- The rate of change in the business reporting environment will make voluntary disclosures even more important then they are today.

Appendix A

BACKGROUND INFORMATION

The AICPA Special Committee on Financial Reporting (the Special Committee) was formed in the spring of 1991 to address concerns about the relevance and usefulness of financial reporting. Edmund L. Jenkins was the chairman of the Special Committee. The Special Committee undertook a major study to determine the needs of users and to identify the types of information most useful in predicting earnings and cash flows for the purpose of valuing equity securities and assessing the prospect of repayment of debt securities or loans. The study sought out direct input from users and included a number of surveys and documents from users' organizations. The Special Committee gathered data about the relative priority that users place on different kinds of information as a means of helping the Special Committee evaluate potential improvements to business reporting.

The Special Committee issued its findings in the 1994 Comprehensive Report, *Improving Business Reporting—A Customer Focus: Meeting the Information Needs of Investors and Creditors.* The Special Committee recommended improving the types of information in business reporting and developed a comprehensive model of business reporting indicating the types and timing of information that the Special Committee believes users need to value and assess the risk of their investments.

The 10 elements included in the Special Committee's comprehensive model are:

- Financial statements and related disclosures
- High-level operating data and performance measurements that management uses to manage its businesses
- Reasons for changes in the financial, operating, and performance-related data and the identity and past effect of key trends
- A description of opportunities and risks, including those resulting from key trends
- Management's plans, including critical success factors
- Comparison of actual business performance to previously disclosed opportunities, risks, and management's plans
- Information about directors, management, compensation, major shareholders, and transactions and relationships among related parties
- Broad objectives and strategies of the company
- Scope and description of the business and properties
- Impact of industry structure on the company.

In 1993, the Association for Investment Management and Research (AIMR) published its study, *Financial Reporting in the 1990s and Beyond* (the Position Paper). That initiative described the financial analysis process and explored the views of financial analysts on the state of financial reporting. The Position Paper also recommended improvements in financial reporting that the AIMR considered significant for the 1990s and beyond.

In February 1996 the FASB issued an Invitation to Comment, *Recommendations of the AICPA Special Committee on Financial Reporting and the Association for Investment Management and Research*, to solicit views on recommendations made to standard setters in both the AICPA and AIMR papers. Issue 1 of the Invitation to Comment asked: "Should the FASB broaden its activities beyond financial statements and related disclosures to also address the types of nonfinancial information that would be included in a comprehensive business reporting model?"

Overall, respondents had mixed views on FASB involvement with nonfinancial information. Some respondents opposed FASB standard setting for the disclosure of nonfinancial information. Other respondents suggested that the Board be selective and initially limit its efforts to focusing on operating data and performance measures and reasons for changes in such data and key trends. Others suggested that the FASB take a primary leadership role in developing the comprehensive model.

At a public Board meeting on January 29, 1998, the Board decided to undertake a research project on business reporting.

The Steering Committee of the Business Reporting Research Project

The Business Reporting Research Project was established in 1998 and was designed to:

- Study present practices for the voluntary disclosure of certain types of business information that users of business reporting might find helpful in making their investment decisions
- Develop recommendations for ways to coordinate GAAP and SEC disclosure requirements and to reduce redundancies
- Study present systems for the electronic delivery of business information and consider the implications of technology for business reporting in the future.

The organizational structure of the Business Reporting Research Project consisted of a Steering Committee and seven Working Groups. The Steering Committee guided, directed, and provided consultative advice to the Working Groups. The members of the Steering Committee and their affiliations are:

Paul Kolton, *Chairman*
Former Chairman
American Stock Exchange
Former Chairman of FASAC

Joseph V. Anania
Board Member, Retired
Financial Accounting Standards Board
(Member of Committee until June 30, 1999)

Janet E. Bergman
Vice President, Investor Relations and Corporate Affairs
Sara Lee Corporation

Robert R. Garland
National Managing Partner
Assurance and Advisory Services
Deloitte & Touche LLP

David B. Kaplan
AcSEC Chairman
Partner
PricewaterhouseCoopers LLP

David F. Larcker
Ernst & Young Professor of Accounting
University of Pennsylvania

Judy C. Lewent
Senior Vice President and Chief Financial Officer
Merck & Co., Inc.

John M. McMillin III
First Vice President
Prudential Securities, Inc.

Thomas P. Moore
Senior Vice President
State Street Research & Management Company

Aulana Peters, Esquire
Gibson, Dunn & Crutcher

Christopher J. Steffen
Former Vice Chairman and Director
Citicorp

Edward W. Trott
Board Member
Financial Accounting Standards Board
(Member of Committee after June 30, 1999)

Robert J. Tuckett
Director of Counterparty Research
Fidelity Investments

Gregory B. Waymire
Asa Griggs Chandler Professor of Accounting
Emory University

John K. Wulff
Chief Financial Officer, Vice President, and Controller
Union Carbide Corporation

The Working Groups

Seven Working Groups were responsible for the basic research or fact-finding for the project. Five of the Working Groups identified present practices in selected industries for the voluntary disclosure of business information. One Working Group considered ways to coordinate GAAP and SEC disclosure requirements and to eliminate redundancies, and one Working Group studied present systems for the electronic distribution of business information and the implications of technology for business reporting in the future. The Working Groups presented their findings in a series of reports and meetings with the Steering Committee.

Industries Studied

Voluntary disclosures of business information were studied for the following companies in the following industries:

Automobiles:
- DaimlerChrysler AG
- Ford Motor Co.
- General Motors Corp.
- Honda Motor Corp.
- Dana Corp.
- Federal-Mogul Corp.

Foods:
- Campbell Soup Co.
- ConAgra, Inc.
- General Mills, Inc.
- H. J. Heinz Co.
- Hershey Foods Corp.
- Kellogg Co.
- RJR Nabisco, Inc.
- Quaker Oats Co.
- Sara Lee Corp.

Chemicals:
- Dow Chemical Co.
- E. I. du Pont de Nemours and Co.
- Ecolab Inc.
- Engelhard Corp.
- Great Lakes Chemical Corp.
- Methanex Corp.
- PPG Industries, Inc.
- Praxair, Inc.
- Rohm and Haas Co.

Pharmaceuticals:
- Abbott Laboratories
- Allergan, Inc.
- ALZA Corp.
- American Home Products Corp.
- Merck & Co., Inc.
- Pfizer Inc.
- Schering-Plough Corp.
- Warner-Lambert Co.

Computer Systems:
- Apple Computer, Inc.
- Dell Computer Corp.
- EMC Corp.
- Gateway 2000, Inc.
- Hewlett-Packard Co.
- Honeywell Inc.
- Xerox Corp.

Regional Banks:
- Bank One Corp.
- BankBoston Corp.
- Fifth Third Bancorp
- KeyCorp
- PNC Bank Corp.
- State Street Corp.
- SunTrust Banks, Inc.
- U. S. Bancorp
- Wachovia Corp.

Oil—Integrated Domestic:
- Atlantic Richfield Co.
- Conoco Inc.
- Kerr-McGee Corp.
- Occidental Petroleum Corp.
- Phillips Petroleum Co.
- Unocal Corp.
- USX-Marathon Group

Textiles—Apparel:
- Burlington Industries, Inc.
- Fruit of the Loom, Inc.
- Liz Claiborne, Inc.
- Oxford Industries, Inc.
- Russell Corp.
- Springs Industries, Inc.
- VF Corp.

The Working Groups identified present practices for voluntary disclosures of the following types of business information:

- Operating data and performance measures and management's analysis of changes in them as well as key trends
- Forward-looking information (such as opportunities and risks and management's plans, including critical success factors)
- Background about the company (such as objectives and strategies, scope of the business, and impact of industry structure on the company) and information about management and shareholders
- Data and related material about intangible assets that are not recognized in the financial statements.

To identify voluntary disclosures of business information the Working Groups analyzed companies' annual and quarterly reports, SEC reports such as Forms 10K and 10Q, press releases, fact books, web sites, and the types of information discussed in conference calls with analysts. All of the information reviewed had been made available to the public.

Structure of the Industry Disclosures Working Groups

Each of the Working Groups had a chairperson and one preparer, user, academic, auditor, and FASB Board member. The Working Group members included a preparer, user, and auditor who came from the particular industry studied.

Members of the Working Group that studied the *oil* and the *chemical* industries are:

Edd K. Grigsby, Chairman
Vice President, Investor Relations
Phillips Petroleum Company

Anthony T. Cope
Board Member
Financial Accounting Standards Board

Dr. D. Gerald Searfoss
Professor of Accounting
University of Utah

Staff Support:

R. Scott Blackley
Senior Manager
KPMG LLP

Oil Industry Only:

John C. Gross
Partner
PricewaterhouseCoopers LLP

J. Mark Hastings
Equity Research Analyst
Global Equity Research
Citibank, N.A.

Ken Huffman
Vice President
Occidental Petroleum

Chemical Industry Only:

Joseph Princiotta, P.E.
Vice President, Senior Credit Officer
Moody's Investors Service

Mickey Foster
Vice President, Investor Relations
Millennium Chemicals, Inc.

Members of the Working Group that studied the *regional bank* industry are:

Thomas P. Moore, Jr., Chairman
Senior Vice President
State Street Research & Management Company

John S. Day
Partner
Arthur Andersen LLP

Edmund L. Jenkins
Chairman
Financial Accounting Standards Board

Michael K. Hughey
SVP, Controller, and Director of Taxes
Mellon Bank, N.A.

Thomas J. Linsmeier
Associate Professor of Accounting
Michigan State University

Thomas D. McCandless
Executive Director
CIBC Oppenheimer

Staff Support:

Myrna H. Parker
Manager
Arthur Andersen LLP

Members of the Working Group that studied the *automobile* and the *textile* industries are:

Gary J. Previts, Chairman
Professor of Accountancy
Weatherhead School of Management
Case Western University

Gaylen N. Larson
Board Member
Financial Accounting Standards Board

William C. Hartman
Director Investor Relations
Eaton Corporation

Carol V. Savage
Vice President, Finance
CBS Corporation

Staff Support:

Aaron S. Ames
Manager
Ernst & Young LLP

Automobile Industry Only:

Brian M. Ambrose
Partner
KPMG LLP

Michael P. Ward
Paine Webber Incorporated

Peter R. Bible
Chief Accounting Officer
General Motors Corporation

Textile Industry Only:

Bradley G. Harris
Deloitte & Touche LLP

Carol Pope Murray
Partner
Salomon Smith Barney Inc.

Staff Support:

Robert J. Laux
Industry Fellow
Financial Accounting Standards Board

Members of the Working Group that studied the *computer systems* industry are:

Jay Hanson, Chairman
McGladrey & Pullen, LLP

Gerhard G. Mueller
Board Member
Financial Accounting Standards Board

W. Bruce Johnson
Professor of Accounting
University of Iowa

Scott Adams
Partner
PricewaterhouseCoopers LLP

Steve J. Brashear
Manager of Financial Reporting
Hewlett-Packard Company

Members of the Working Group that studied the *pharmaceutical* and the *food* industries are:

L. Hal Rogero, Jr., Chairman
Assistant Corporate Controller
The Mead Corporation

Kirsten M. Ely
Assistant Professor
Emory University

Staff Support:

Paul R. Rogers
Senior Manager
Deloitte & Touche LLP

Pharmaceutical Industry Only:

Thomas H. Kelly
Vice President and Controller
Schering-Plough Corporation

Edward J. Giniat
Worldwide Healthcare Industry Director
Arthur Andersen LLP

Kent J. Blair
Vice President
Donaldson, Lufkin & Jenrette

Joseph V. Anania
Board Member, Retired
Financial Accounting Standards Board

Food Industry Only:

John C. Bierbusse
Vice President
A.G. Edwards & Sons, Inc.

H. Craig Christiansen
Audit Partner
Deloitte & Touche LLP

Leonard F. Griehs
Vice President–Investor Relations
Campbell Soup Company

Edward W. Trott
Board Member
Financial Accounting Standards Board

GAAP-SEC Disclosure Requirements

The GAAP-SEC Redundancies Working Group's report containing its findings, recommendations, and observations was considered and approved by the Steering Committee. The report identifies redundancies between GAAP and SEC disclosure requirements and suggests ways to eliminate them. The report also suggests other potential improvements to disclosure requirements. That report was issued concurrently with this Report and is available, at no cost, on the FASB web site at www.fasb.org.

Electronic Distribution of Business Information

The Steering Committee considered and approved the report of the Working Group that studied present systems for the electronic delivery of business information. The Steering Committee issued that report in January 2000, and it is available, at no cost, on the FASB web site at www.fasb.org.

Among the report's highlights are identification of (a) leading-edge technologies as well as core features of corporate web sites, (b) divergent corporate strategic objectives and uses of the Internet, (c) notable current practices in terms of content and presentation, and (d) legal issues and questions related to web site practices.

Appendix B

RESEARCH ABOUT THE BENEFITS OF INFORMATIVE DISCLOSURES

Introduction

The Steering Committee encourages companies to provide expanded disclosures of meaningful business information. Expanded disclosures that increase “transparency” provide benefits to companies, investors, and the general economy.

Investors benefit from increased transparency because it enables them to make more informed investment decisions. The economy benefits from the more effective allocation of capital, the investment effect of a lower cost of capital, and more liquid capital markets.

Companies benefit from a lower average cost of capital. Enhanced disclosures reduce investors’ risk of making poor investment decisions. A company’s cost of capital includes a risk premium resulting from investors’ uncertainty about the adequacy of the information available about the company. Increased transparency reduces that uncertainty premium.

Definitive quantification in reliable dollar figures of the benefits to companies of expanded disclosures is not possible. Nevertheless, the Steering Committee encourages academics and others to undertake research about the correlation between expanded disclosures and the cost of capital. Synopses (prepared by the researchers) of three recent research studies are presented below.

* * * * *

Disclosure Level and the Cost of Equity Capital

(Originally published in *The Accounting Review*, vol. 72, no. 3, July 1997, pages 323–349.)

Christine A. Botosan
University of Utah

One of the principles that guides the activities of the Financial Accounting Standards Board is to issue standards only when the expected benefits exceed the perceived costs. Providers and users of corporate information, however, often hold different views concerning the cost/benefit tradeoff associated with a proposed standard. The costs and benefits of disclosure are not well defined and are difficult to quantify. Academic research into the costs and benefits of disclosure can help to provide structure to the debate by identifying the costs and benefits of greater disclosure and providing some evidence as to their magnitude.

Existing theoretical research implies that enhanced disclosure leads to a lower cost of equity capital through enhanced market liquidity and/or reduced uncertainty. However, empirical research into the association between greater disclosure and cost of equity capital is limited because disclosure level and cost of equity capital are difficult to measure reliably. A paper entitled "Disclosure Level and the Cost of Equity Capital," published in the July 1997 issue of *The Accounting Review* attempts to overcome those difficulties and provide some evidence on the association between disclosure level and cost of equity capital.

In this study, the amount of voluntary disclosure included in a firm's annual report is used to rank disclosure levels across firms. The level of voluntary disclosure provided by a firm is quantified via a disclosure index, which includes items investors and financial analysts find useful in investment decision making. Examples of items included in the index are management discussion of the competitive environment, principal products produced, principal markets served, reasons for changes in sales and income and management's objectives and business strategy; summaries of annual and quarterly historical results; statistics such as market share, units sold, order backlog and average compensation/employee; and forecasted operating and financial data. In total the disclosure index includes approximately sixty-five disclosure items.

Using this index, a disclosure score is computed for each of the 122 manufacturing firms included in the sample by awarding points for each item disclosed in the company's 1990 annual report to shareholders. The sum of these points yields a total disclosure score for each firm that serves as the basis for the disclosure ranking.

Cost of equity capital is computed using an accounting based valuation formula developed, in part, by Professor J. Ohlson.[1] After entering current stock price and *Value Line* forecasts of earnings, book value and future stock price into the formula, a firm's cost of equity capital can be estimated.

Consistent with prior research, the cost of equity capital estimates are positively associated with firm risk (as measured by market beta) and negatively associated with firm size. The average cost of equity capital for the sample examined is 20.1%; somewhat high but in line with estimates of the risk free rate, market risk premium and the average

[1]Ohlson, J. "Earnings, Book Value, and Dividends in Security Valuation," *Contemporary Accounting Research* (Spring 1995): 661–687. The model used here is found in Abarbanell and Bernard, 1994, "Is the US Stock Market Myopic," University of Michigan Working Paper.

estimate of market beta for the sample which combined suggest an average cost of equity capital of about 17% before considering the effect of uncertainty. Together these results suggest the cost of equity capital estimates computed using the accounting based valuation formula are reasonable.

With the measures of disclosure level and cost of equity capital described above, the association between them is examined by performing statistical analyses between cost of equity capital and market beta, firm size and disclosure level using the sample as a whole, and two sub-samples of firms. Sub-samples of firms with light versus heavy analyst following are examined separately because the disclosure index is assumed to capture variation in firms' disclosure levels overall even though it is limited to the annual report. When the annual report plays a central role in the communication process, this assumption is reasonable. But, when analysts more actively monitor a firm's performance using a variety of information sources, the annual report may not play as critical a role in the communication process thereby violating this assumption. As a result, the disclosure index may provide a better measure of overall disclosure level when a firm is not widely followed by financial analysts.

The results suggest that for lightly followed firms, cost of equity capital decreases as disclosure level increases, after controlling for firm risk (as measured by market beta) and firm size. The results indicate that the lightly followed firm that disclosed the most enjoys about a nine-percent reduction in its cost of equity capital relative to the firm that disclosed the least. Alternatively, a one-unit difference in the disclosure measure is associated with a difference in the cost of equity capital of 28 basis points, on average. In contrast, no association between disclosure level and cost of equity capital is detected for heavily followed firms.

If the disclosure measure does a good job of measuring overall disclosure level, the latter result suggests that heavily followed firms that disclose "more" are not rewarded for their efforts with a lower cost of equity capital. On the other hand, if the disclosure measure does a good job of measuring annual report disclosure level but not *overall* disclosure level, the results imply that providing greater disclosure via the annual report is less important for heavily followed firms.

Academic research that attempts to distinguish between these competing explanations and add to our understanding of the association between disclosure and cost of equity capital is ongoing. The evidence provided by this and other academic research into the benefits and costs of enhanced disclosure will assist the Financial Accounting Standards Board and its constituents as they grapple with the cost/benefit tradeoff associated with each new proposed standard.

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Appendix B

Corporate Disclosure Quality and the Cost of Debt

(Originally published in *The Accounting Review,* vol. 73, no. 4, October 1998, pages 459–474.)

Partha Sengupta
University of Hawaii, Manoa

In this paper I document a negative relationship between the nature of a firm's overall disclosure policy and the interest rate at which they can borrow money from public sources. This result indicates that potential bondholders and underwriters evaluate a firm's overall disclosure policy in setting interest rates. Firms that are perceived (by the lenders) to be secretive and less forthcoming in disclosing useful information are considered more risky. As a result these firms are charged a higher risk premium. Investors and financial analysts have long acknowledged that improved disclosures result in better access to financial capital. For example, Eccles and Khan (1998), document that a large percentage of sample investors and financial analysts perceived that improved access to new capital is an important sustained benefit of improved corporate information disclosures. My study provides empirical support for that perception.

I measure a firm's disclosure policy by financial analysts' evaluations of corporate disclosure practices, available from the annual volumes of the *Report of the Financial Analysts Federation Corporate Information Committee.* Each volume provides evaluations of a sample of firms based on their disclosures through annual and quarterly reports, 10K, press releases and other public announcements, and discussion with financial analysts. The evaluations are typically summarized in the form of a score (out of 100 available points). I associate this disclosure measure with two alternative measures of the cost of debt of a firm: (1) the yield to maturity on new debt issues, and (2) the total interest cost of new debt issues, which is based on the amount received by the issuer, net of underwriter discount.

Based on a sample of 102 firms, my results show that both measures of cost of debt are negatively associated with the disclosure measure, after controlling for other potential determinants of the interest rates such as firm specific risk, loan characteristics, and market conditions. In other words, firms that are perceived by financial analysts to be superior in their disclosure efforts, on average, enjoy a lower yield to maturity on their new debt issues as well as a lower effective interest on their new debt issues after accounting for underwriter discounts. The results also indicate that on average, a one percent increase in the disclosure measure results in approximately 0.02 percent reduction in the total interest cost of the firm. This implies that other things remaining constant, the firm with the highest disclosure score in the sample (96.37) enjoys a total interest cost that is approximately 1.1 percentage point lower than the firm with the lowest disclosure score

(43.83) in the sample. For the high disclosure firm, this translates into annual interest savings of over $5 million on its $500 million debt issue.

I also examined if the lenders rely more heavily on corporate disclosures when the market uncertainty surrounding the firm is high. I found that the negative association between corporate disclosure scores and both measures of cost of debt are stronger for firms facing above-average volatility in stock returns (as compared to firms facing below-average volatility in stock returns). This supports the arguments that lenders rely more heavily on the firm's own disclosures when the market is uncertain about the firm's future.

My study adds to the findings of Botosan (1997) who explored the association between disclosures in annual reports for the machinery industry and a firm's cost of *equity* capital. She found a negative association between the disclosure measure and the cost of equity capital for firms with low analyst following but the results did not extend to firms with high analyst following. I extend the investigation of the consequences of disclosures by providing evidence of a link between disclosure quality and the cost of *debt* capital. Although previous studies have not explored this relation, the issue is important because debt financing is the predominant form of external financing for publicly traded firms in the U.S. For example, during 1992, publicly traded companies raised approximately 2,764 billion dollars through investment grade debt issue (which excludes mortgage and government-backed debt, convertible debt, and junk bonds) in comparison to approximately 932 billion dollars raised through common and non-convertible preferred stock issue. Thus the results of my study provide evidence of an important benefit of corporate disclosures.

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Appendix B

Stock Performance and Intermediation Changes Surrounding Sustained Increases in Disclosure

(Originally published in *Contemporary Accounting Research*, vol. 16, no. 3, fall 1999, pages 485–520, ©The Canadian Academic Accounting Association.)

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In 1991 the AICPA formed a Special Committee on Financial Reporting to address increasing concerns about the relevance and usefulness of financial reporting. The Committee's charge was to recommend the type and extent of information that management should make available to other stakeholders. After several years of research, the Committee recommended that companies provide investors with a number of additional disclosures, including more segment details, supplemental non-financial data, and additional forward-looking information. The Committee suggested that companies that disclose such information are likely to receive private benefits from a lower cost of capital.

Academic models of disclosure predict that expanded disclosures have two potential benefits for firms. First, they can help correct any firm misvaluation, and second, they can increase institutional interest and liquidity for a firm's stock. However, there are also reasons to question the benefits of voluntary disclosures. Given potential conflicts of interest between managers and outside owners, management disclosures may not be viewed as credible by investors. In addition, some managers argue that increased disclosure reduces shareholder value by revealing valuable information to competitors or by increasing legal costs for the firm. It is therefore an interesting empirical question whether firms that increase disclosure show any increase in stock performance or stock market intermediation.

Our research examines factors associated with expanded voluntary disclosure using a sample of firms with large and sustained increases in their disclosure strategies. The sample firms are identified using analysts' evaluations of firms' disclosure practices provided in the annual *Report of the Association of Investment Management and Research Corporate Information Committee (AIMR Reports)*. We identify 97 firms that have significant and sustained improvements in their disclosure rating during the period 1980 to 1990, and investigate whether their expanded disclosure is accompanied by improved stock performance and capital market intermediation.

One potential concern with using analysts' ratings of disclosures as a proxy for improved firm disclosure is that analysts' ratings may not be really driven by firms' disclosure strategies, but rather by extraneous considerations, such as firm performance or analysts' personal relationships with management. To examine this concern, we presented evidence on whether changes in analysts' ratings appeared to reflect actual changes in firms' disclosure. Using the qualitative discussions and sub-category ratings provided in the *AIMR Reports,* we documented the particular disclosure changes that lead analysts to upgrade ratings for the sample firms. These included: (a) improved segment disclosures; (b) more in-depth discussion of operations and financial performance, and more candid management discussion of the company's prospects in annual and quarterly reports; (c) publication of supplemental disclosures in fact books; and (d) improved investor relations through increased analyst access to top management, and additional company meetings and presentations for analysts. Where possible we corroborate these changes using disclosure documents prepared by the sample firms.

Our findings on the stock price performance indicated that on average the sample firms showed a 7% improvement in stock performance in the year of the disclosure increase and 8% the following year. We also find that in the year of the disclosure increase and three following years on average the sample firms experienced annual increases in institutional ownership of 12%–24%, were followed by more financial analysts, had increased stock liquidity, and lower investor uncertainty.

The findings are consistent with the predictions of the disclosure literature. However, if the sample firms show strong earnings performance in the event period, then it is possible that the expanded disclosure consists of nothing more than management trumpeting this improved earnings performance. The stock price and intermediation effects are also potentially attributable to the improved earnings performance, rather than to the changes in disclosure strategy. We therefore conducted multivariate tests to control for earnings performance, as well as other economic determinants of stock returns and capital market intermediation, such as risk and firm size. Our multivariate analysis suggests that, after including these controls, increased disclosure is related to improved stock performance and liquidity, as well as growth in institutional ownership and analyst coverage.

One question arising from our findings is what explains the timing of management's decisions to expand disclosure? We provided indirect evidence on this issue by documenting that the disclosure improvements are accompanied by increased use of public debt markets compared to firms with no improvement in disclosure rating.

Appendix C

FINDINGS OF THE WORKING GROUPS THAT STUDIED VOLUNTARY DISCLOSURES OF BUSINESS INFORMATION IN EIGHT INDUSTRIES

CONTENTS

Automobile Industry

Aspects of the business that are especially important to the success of companies in the automobile industry include (a) market share and new products, (b) capacity and cost containment, (c) the work force, and (d) management strategy.

Business Data

Market Share and New Products

- Details of growth in market share in all major regions and countries
- Listing of vehicle units sold, growth in vehicles sold, and average prices

Capacity and Cost Containment

- Disclosure of quarterly capacity utilization of production facilities

Work Force

- Description of labor contracts in the United States and Europe
- Detailed average compensation by employee groups, by year
- Disclosure of employment by regions

Management Strategy

- Ten years of the yen/U.S. dollar exchange rate, which has a major impact on profitability.

Management's Analysis of Business Data

Market Share and New Products

- Analysis of the automobile marketplace in each major region and/or country
- Discussion of new product developments

Capacity and Cost Containment

- Average age of key assets and weighted-average service life of major classifications of property, plant, and equipment

Work Force

- Detailed information about the impact of strikes

Management Strategy

- Discussion, by regions, of the year's highlights and accomplishments, management responses to business climates, investments in capacity and in partnerships, earnings trends, liquidity review, and strategic position
- Detailed discussion of economic value added (EVA), including what it is, why it is important to the company, and how it is computed.

Forward-Looking Information

Market Share and New Products

- Summary of new products that will be produced in the next years
- Forecast of unit sales for the coming year in each major country
- World economic and industry outlook and total expected industry units by major country or region
- Competitive position goals

Capacity and Cost Containment

- Disclosure of plans for increases in production capacity for the next two years
- Discussion of the company's future technology and products
- Coming-year production capacity and strategic goals for self-reliance
- Description of the company's cost reduction programs, which include ending certain models of its automobiles

Work Force

- Disclosure of the number of anticipated layoffs upcoming at a particular plant

Management Strategy

- Goals for next year and after by segment
- Report on the company's effectiveness during the past year in meeting its beginning-of-year performance targets, which included vehicle unit sales, sales and revenues, net income, and capital expenditures
- The company's goals—the five-year sales target; zero defects; achievement of positive EVA
- Company initial public offering share distribution plans certain target amount for cash and marketable securities for funding in a downturn
- Post merger revenue and performance targets

- Strategy to reduce dependence on original equipment manufacturers (OEMs) and to develop new products to account for a certain percentage of annual future revenue
- Description of the company's acquisition strategies and identification of pending acquisitions including various information about the companies and the expected impact.

Information about Management and Shareholders

- Disclosure of principal stockholders and creditors by name
- Photo spread and detailed information on board of directors
- Composition of individual and institutional shareholders by percentage of ownership.

Background about the Company

- Discussion of the company's vision and values
- Detailed summary of the company's history and major milestones
- Disclosure of the principal manufacturing facilities and the products manufactured and the number of employees.

Information about Unrecognized Intangible Assets

- Patent history disclosing patent applications and awards for a subsidiary that manufactures parts
- Detailed listing of all the company's major brands and a business unit listing
- Description of new research and development programs to reduce fuel consumption and to improve the recyclability of materials.

Other Observations

- OEMs provide to the investment community a monthly market share report and a quarterly production schedule. This is the input for a worldwide aggregate analysis on a comparative basis that is reported in industry and general media outlets. Those outlets also report on production capacity accomplishments, for example, weekly updates of North America vehicle production by manufacturer or by vehicle type so as to compare actual production and market share and to provide change and trend analysis.
- Arrangements with key suppliers may be significant given the supply chain economics of the industry, but disclosures about supplier contracts were not highly detailed or explained. Some contracts may be of short duration, but a list of an OEM's top suppliers would be potentially useful.
- Brand loyalty is an important factor for companies in the industry. Companies disclosed brand logos and lists of brands, but there was virtually no attempt to discuss strategies for the development of brands and little discussion of intangible and knowledge assets.

Chemical Industry

Aspects of the business that are especially important to the success of companies in the chemical industry include (a) capacity and demand, (b) products and prices, (c) operating costs, (d) new plant, technology, and R&D, and (e) management strategy.

Business Data

Capacity and Demand

- Plant capacities by product, including the past year's additions to those capacities and the additions scheduled for the upcoming year
- Listing of acquisitions and divestitures over a period of years and the impact on capacities

Products and Prices

- Presentation of the market share of chemicals sold in a particular market, organized by the stages in that market's manufacturing process and each chemical used at each stage of the process
- Eleven-year comparisons of selling price and raw material price indices
- Quarterly changes in physical volume of product by business group and by geographic location of customer, expressed as percentages
- An extensive discussion of the risk factors in the industry, such as price volatility and cyclicality of demand for certain products
- Percentage change in selling prices and sales volume shown graphically over 10 years
- An entire brochure focused on a very significant specialty product, a description of the related manufacturing process, and uses of the product by customers
- Market profile of customer end products, with graphics indicating the percentage of total sales, and a narrative description of the products and a discussion of the potential for growth
- Tabular presentations of product groups, worldwide market potential stated in dollars, and projected annual industry growth expressed in percentages

Operating Costs

- Productivity gains for a five-year period in terms of reductions in operating costs and selling, general, and administrative expenses (SG&A)
- Productivity gains over several years in terms of sales per employee and EBIT per employee
- Raw materials price indexes for four major materials for each of five years

New Plant, Technology, and R&D

- Information related to major business segments, such as capital expenditures, perceived technology advantages, and expansion of capacities
- Tabular presentation of R&D expenditures for major product areas for five years

Management Strategy

- Graph depicting the resiliency of earnings per share to price changes over several years that demonstrates the company's ability to maintain earnings in the face of price volatility
- Tabular presentation of exposure to derivatives due to open metal positions (platinum, gold, silver, and base metals) and open buy and sell foreign currency forward contracts for each of 10 different currencies
- Discussion of the application of EVA throughout the company and the company's commitment to enhancing shareholder value.

Management's Analysis of Business Data

Products and Prices

- Management's discussion of the historical and potential future impact of the risk factors in the industry, such as price volatility and cyclicality of demand for certain products
- Supplemental quarterly analysis of volume, price, and cost trends by segment
- Percentage of net sales to non-US customers for each of three years

Management Strategy

- Detailed analysis of quarterly changes in basic earnings per share; the dollar impact is reflected for changes that affected gross profit, such as selling prices, physical volume and product mix, and manufacturing costs; the effect of other items such as SG&A and gains and losses on sales of capital assets were also shown
- Calculation of "economic value created" for each of the past two years.

Forward-Looking Information

Products and Prices

- Expected downward pressure on prices due to the introduction of the Euro
- New products in the pipeline for two business segments projected out six years
- Discussion of the economic environment geographically and by industry, and the potential impact on performance

Operating Costs

- Discussion of the negative cost impact of continuing price inflation related to raw materials and the use of raw material substitutions and planned improvements in manufacturing efficiencies to mitigate inflation
- Prior-year graphical presentation of changes in productivity in the form of cost savings, together with a four-year projection

Management Strategy

- Discussion of the strategies in several business segments, including a privatized chemical operation in a former Soviet Bloc country; for example, cost reductions, outsourcing, and capital investments
- Discussion of specific objectives including to become the lowest cost producer, maintain a broad and strong portfolio of products, achieve financial flexibility, and improve the resiliency of earnings relative to price volatility
- Extensive presentation focused on the perceived growth drivers—discusses business characteristics necessary to be recession resistant, opportunities for cross selling, specialization, differentiation, and penetration
- Disclosure of projected earnings and free cash flows by segment
- Presentation regarding the opportunities to utilize e-commerce to improve effectiveness and efficiency, and develop growth opportunities; indicated e-business capabilities already developed in the company
- Announcement of intentions to reduce capital expenditures, reduce accounts receivables, inventories, and costs, and focus the incentive plan for senior management on free cash flow
- Bubble chart depicting the earnings to free cash flow relationship for major business segments
- Performance objectives for cost of capital, ROE, and growth
- Graphic presentation of past and future earnings patterns in terms of percentage change.

Information about Management and Shareholders

- Details about employee stock ownership, categorized by executive management, other management, and all other employees. Reflects pay at risk, 401(k), and stock options
- Disclosure of the required stock ownership goals for senior executives and market value of the common stock owned per executive as a percentage of salary that year
- Discussion of transition of leadership due to retirement of chairman and CEO.

Background about the Company

Product and Prices

- Graph displaying breakdown of sales by distribution method, for example, deliverable liquids and packaged products, and sales by markets/industries served
- Flowchart describing the production process of one of the company's major products
- Web site focused on one major customer segment (for example, aerospace) indicating, in detail, every product as it is applied to the many specific applications by the customers in that segment, and the reason for its use
- An entire brochure describing the products and market position of a joint venture in which the company is a significant investor; the joint venture is the largest producer of a particular chemical product in North America

Management Strategy

- The Environmental, Health & Safety Report includes an extensive history of the company and discusses the company's commitment to and activities related to environmental, health, and safety issues. This type of report and level of discussion are unique to this industry.

Information about Unrecognized Intangible Assets

Products and Prices

- Identification of the 26 major customers by logo
- Discussion of the major investment in customer technical and support services, training, R&D, and so forth, by operating division
- Disclosure of recently acquired major new customers

New Plant, Technology and R&D

- Discussion of the process applied in appraising the financial feasibility of in-process research; the process was based on measuring at present value the risk-adjusted cash flows at a discount rate 2 percentage points higher than the estimated weighted average cost of capital in this industry
- Disclosure of the number of scientists, technicians, and other personnel utilized in R&D.

Other Observations

- The prices of commodity chemicals are mostly determined by the amount of supply, and information about inventory levels is critical. Overall industry supply information is published by several third parties including the Department of Commerce and is considered a leading indicator of prices.
- Pricing information is very sensitive because companies are concerned about individual customers becoming aware of prices charged to other customers. Thus, disclosures about prices were in terms of percentage increases or decreases rather than absolute amounts.
- There has been a significant increase in the quality of voluntary disclosures by companies in this industry over the last five years. This has resulted from competition—competition for capital. After one company provides a particular disclosure requested by investors, other companies tend to follow suit.

Computer Systems Industry

Aspects of the business that are especially important to the success of companies in the computer systems industry include (a) revenue streams, (b) efficiency/profitability, (c) new products/brand name, and (d) management strategy.

Business Data

Revenue Streams

- Revenue and revenue increase from products and type of customer
- On-line sales revenue dollars per day and percentage increase
- Market position for manufacturing and marketing personal computers in the United States and worldwide
- Table of monthly orders broken down by strategic business unit and by product category
- Quarterly sales, number of units sold, and unit growth by product category

Efficiency/Profitability

- Three-year table of the ratio of operating expenses to net revenue
- Graphs for four years depicting return on invested capital and market capitalization
- Percentage return on invested capital compared with that of the industry
- EVA performance over the last three years

New Products/Brand Name

- Information about the rollout of new products and the expansion of high-growth product lines
- Disclosure of statistics on a customer survey of factors affecting product selection, and ratings from a survey of customer satisfaction

Management Strategy

- Disclosure that prices set for products reflect anticipated changes in foreign exchange rates
- A good discussion of actions taken and expected outcomes by a company in a financial “turnaround” situation.

Management's Analysis of Business Data

Revenue Streams

- Sales growth is partially attributed to Internet sales, which also increased customer satisfaction and lowered operating cost
- Disclosure of the company's goal for the percentage of revenue from products introduced within the last three years together with a five-year chart on revenues from products introduced in the last three years

Efficiency/Profitability

- Explanation that the increase in gross margin results from cost declines and changes in the product mix
- Performance (benchmarked against many of the company's peer companies) for revenue growth, earnings growth, cash flow, ROE, and total shareholder return
- Quarterly disclosure of free cash flow and extensive discussion of reasons for changes from the prior year's quarter.

Forward-Looking Information

Revenue Streams

- Expected sales growth from future industry demand
- Discussion of the growth opportunities in the company's four major customer categories

Efficiency/Profitability

- Disclosure of next year's targets for growth in revenues, net income, and gross margin and for reducing the ratio of expenses to revenues

New Products/Brand Name

- The increase in R&D spending to be invested in new product development

Management Strategy

- Disclosure that all future expansion will be financed from internally generated funds.

Information about Management and Shareholders

Nothing was found that represented unique and/or exceptionally useful information beyond information that is currently required or generally provided.

Background about the Company

Efficiency/Profitability

- Description of strategy to control operating expenses
- Strategy to increase investment in information systems to support growth while managing expenses
- A list of the analysts (and their affiliation) that follow the company

New Products/Brand Name

- Description of strategy for spending on R&D
- Discussion of the rollout of the company's first global marketing campaign to support its brand name

Management Strategy

- Discussion of the company's transition from a country-based management approach to a strategic-lines-of-business management approach
- An in-depth discussion of the key business risks facing the company.

Information about Unrecognized Intangible Assets

- The number of patents held and a list of trademarks for the company's products
- Customer brand awareness statistics and the increase from the prior year
- Disclosure about the types of research being performed within the company's various business units.

Other Observations

- Among the companies studied, those with a narrower range of products did a more complete job of describing products, marketing methods and strengths, competitive position, strategies, and so forth. Descriptions by companies with a broader range of products did not go into an equivalent depth of detail.
- Many of the companies studied made extensive use of their web sites to disclose business information. For one company, their web site was the only source of information.

Food Industry

Aspects of the business that are especially important to the success of companies in the food industry include (a) sales growth, (b) margin enhancement, (c) product innovation and quality, (d) brand effectiveness, and (e) management strategy.

Business Data

Sales Growth

- Discussion of change in approach to Asian region sales strategy
- Discussion of product focus by region
- Competitive, market share, and marketing information about international operations
- Disclosure of product line growth rates
- Disclosure of number of domestic and international processing plants
- Discussion of expanded presence in international locations through joint ventures
- Percentage changes in unit volume sales
- Discussion of marketing and promotion techniques
- Discussion of the impact of foreign currency exchange rates on operations
- Amount of spending on product promotions
- Discussion of the impact of acquisitions on sales results

Margin Enhancement

- Financial highlights that disclose alternative performance measurement statistics, including cash margins and cash return on assets
- Comparison of gross margins of industry competitors
- Comparison of average capital expenditures as a percentage of sales for industry competitors
- Comparison of selected benchmarking data
- Listing of cost reductions by year

Product Innovation and Quality

- Comparison of product growth rates with those of the industry
- Disclosure of the impact of new products in recent years on the rate of sales growth
- Discussion of products built around health benefits leading to increases in retail volume
- Listing of introduction dates of new products during the last several years

Brand Effectiveness

- Identification of competitors and product category market shares
- Advertising as a percentage of sales comparison for company and its competitors
- Disclosure of sales growth for specific products and brands
- Comparison of growth rates among selected brands
- Disclosure of category share
- Disclosure of percentage growth in "ready-to-eat" products
- Discussion of the impact of specific brands on company performance
- Discussion of category management techniques
- Comparison of brand and private-label price groups

Management Strategy

- Clearly stated financial performance objectives
- General discussion of management's performance targets
- Discussion of EVA trends
- Disclosure of targeted dividend payout ratio.

Management's Analysis of Business Data

Sales Growth

- Discussion of increased use of co-manufacturing arrangements in recent years
- Description of various licensing agreements
- Discussion of the impact of market conditions on sales volume and product pricing
- Growth of recently acquired businesses separated from established businesses
- Discussion of strong unit volume growth, margin improvement, and increased earnings contribution from international operations
- Discussion of the impact on operations of international economic conditions
- Discussion of effective merchandising campaigns

Margin Enhancement

- Discussion of the impact of the decision to discontinue inefficient trade spending practices
- Historical information demonstrating trends in raw material prices
- Discussion of productivity gains
- Discussion of the complexity of managing several stock-keeping units, customers, and so forth

Product Innovation and Quality

- Discussion of new products designed to deliver increased levels of nutrition, convenience, and portability
- Comments on demand and supply for special packaged products
- Identification of products as part of a larger product group and ranking of product convenience
- Summary of consumers' level of concern about specific health matters

Brand Effectiveness

- Summary of historical private-label product performance for a specific category

Management Strategy

- Comprehensive explanation of a company's restructuring program
- Capital spending initiatives.

Forward-Looking Information

Sales Growth

- Intent to grow internationally by emphasizing key brands
- Extensive category management is a competitive advantage and is anticipated to drive sales increases
- Plans for expansion and specific brand introductions into specific international regions
- Plans for acquisitions and joint ventures in future periods
- Anticipated impact of foreign economic conditions on operations
- Identification of certain brands as key growth drivers
- Expectations of sales volume growth rates

Margin Enhancement

- Expected sources of future cost savings
- Expectations for future ingredient costs
- Future productivity plans and dollar savings goals
- Earnings expectations in relation to analysts' estimates

Product Innovation and Quality

- Description of perceived opportunities in product packaging
- Identification of the growing popularity of organic foods as an important consumer health trend
- Anticipated packaging that highlights calcium fortification and powerful television advertising to communicate meaningful improvement in popular brands
- Plans to leverage customers by consolidating separate brand and category sales organizations
- Promotion of a program to safeguard baby food quality

Brand Effectiveness

- Disclosure of brand building efforts that are generating broad-based volume and share increases in markets around the world
- Plans to aggressively market consumer brands for market leadership positions
- Discussion of promising brand effectiveness for specific products
- Plans to broaden the appeal of brands through line extensions and increasing the frequency of consumption

Management Strategy

- Discussion of anticipated drug and grocery store consolidations and related opportunities and pressures
- Plans to achieve sustainable savings and profit leverage in the near term
- Future EPS growth targets
- Plans to reinvest future cash flows at an increased rate to produce more “economic” value
- Plans to develop mutually beneficial, interdependent relationships with trade customers to improve the economic return of both parties
- Plans to improve the productivity of low-return businesses or divest them.

Information about Management and Shareholders

Management Strategy

- Listing of “Requirements of Management and Directors” and the “Evaluation of Board Performance” program
- Management share ownership requirements by position
- Note that board of directors was ranked the “Best Board in America” by an independent evaluation

- Disclosure that salaries are established according to positions held and are compared with salaries of other similar companies
- Discussion of corporate governance standards
- Description of a simplified management structure that removed one layer of senior management.

Background about the Company

Sales Growth

- Description of advantages and disadvantages of thematic advertising
- Description of joint venture sales arrangements
- Detailed listing of products, brands, and registered trademarks

Margin Enhancement

- Various cost control statistics for the company
- History of sales volume increases and decreases by foreign region

Product Innovation and Quality

- Discussion of the company's six key factors in a successful new products program
- Strategy to develop pipeline of ideas that fit the lifestyles of consumers
- Identification of the company's innovation goals

Brand Effectiveness

- Description of advertising and marketing philosophies, media placements, and sponsorships
- Identification of brands and market share rankings

Management Strategy

- Description of the company's long-term performance objectives
- Discussion of the company's code of conduct and mission statement
- Listing of key drivers of company's profitability
- Listing of key business events for the recent life of the company
- Description of three primary performance benchmarks: free cash flow, EPS, and EVA
- Identification of principal areas of competition as quality, price, advertising, promotion, and service
- Listing of financial analysts that follow the company.

Information about Unrecognized Intangible Assets

Sales Growth

- Description of new products "funnel" being full at all times with products in various stages of development

Margin Enhancement

- Discussion of the impact of an enterprise resource planning and supply chain management system and financial shared services

Product Innovation and Quality

- None noted

Brand Effectiveness

- Discussion of sponsorship of NASCAR, NFL, NCAA, Final Four, and so forth

Management Strategy

- Discussion of the importance of trademarks to the company
- Discussion of the importance of brands to the company's success.

Other Observations

- The food industry is highly competitive with significant focus placed on sales growth and cost containment. Many voluntary disclosures focused on analytical and statistical data surrounding sales by product, market, region, and so forth. Also, statistics about cost effectiveness and operating efficiencies were emphasized by all of the companies reviewed. A considerable amount of voluntary disclosure was related to the analysis of underlying sales and cost details contained in the historical financial statements.
- Many companies within the industry are striving to identify new alternative uses for mature products. Some voluntary disclosures discussed these alternative uses; however, there was limited detail as to the success of these product promotion efforts. Certain high-level consumer trends were discussed by the food companies, but there was only limited forward-looking discussion of how the companies were planning to address these trends.
- Frequent restructuring charges are taken by companies to reduce cost structures. Voluntary disclosures by some food companies provided both the details of the restructuring charges and an informative description of the operational issues the restructur-

ing is attempting to address. Other companies provided a minimum level of disclosure that focused on the financial impact of the restructuring. Disclosures that focused more on the operational issues provided a much clearer understanding of the factors surrounding the restructuring charge.

- There were few disclosures related to intangible assets. The primary intangible asset discussed by each company was its product brand names. Brand name performance was often discussed by food industry companies in terms of increases or decreases in sales. However, the intangible value in brand names and the impact of private-label products on these brands was not discussed in any significant detail.
- Brand effectiveness is measured by two statistical reporting services to which most food industry participants subscribe. Data are generally used to measure effectiveness of brands through market share and other metrics.
- Overall, voluntary disclosures were somewhat general with only a limited number of detailed voluntary disclosures. The most detailed voluntary disclosures were certain financial ratios and historical financial performance measures. Disclosures of forward-looking information and intangible assets were infrequent and general in nature. The importance of cost controls and competitive pressures driving the demand for improved profitability were addressed frequently. However, those items were most often addressed through management's analysis of historical financial data and not through the discussion of forward-looking information.

Oil—Integrated Domestic Industry

Aspects of the business that are especially important to the success of companies in the integrated domestic oil industry include (a) acquisition of reserves, (b) extraction of reserves, (c) refining, (d) sales and marketing, and (e) management strategy.

Business Data

Acquisition of Reserves

- Replacement of reserves used up in production
- Finding costs worldwide for 10 years, broken down by domestic and international properties, for both proved and unproved reserves
- Net exploratory and development wells categorized by domestic and international
- Finding and development costs for specific fields

Extraction of Reserves

- Productivity of major fields over a 10-year period
- Producing properties by major field or country, with proved reserves and production rate
- Initial production rates from new fields
- Test flow rates for new exploration wells
- Source of crude processed, by region, for the past five years

Refining

- Total refinery capacity and the input and output in barrels per day, by refinery, for the past five years
- Average daily production statistics, for oil (barrels/day) and natural gas (MM cubic feet/day), segmented by region, for five most recent years
- Refined product yields and sales volumes of various refinery products (thousands of barrels/day) for past five years

Sales and Marketing

- Operating income on a barrel of oil equivalent (BOE) basis, along with West Texas Intermediate (WTI) prices, for past five years
- Refined product sales by class of trade, that is, wholesale, retail, and so forth
- Average industry prices and refining spreads for the last eight quarters

Management Strategy

- Capital expenditures by segment, divided between United States and international, for the past five years, with narrative description of projects involved
- Table of financial ratios for three years, including current ratio, total debt/capitalization and floating-rate/total debt.

Management's Analysis of Business Data

Acquisition of Reserves

- Management discussion of production volume drivers (that is, disposal of assets, new discoveries, and so forth)
- Increase in inventory of drilling prospects

Refining

- Sensitivity of operating profit, earnings, cash flow, and EPS to changes in the unit price of a major chemical product, refined product, crude oil, and natural gas
- Analysis of reasons for production and throughput differences

Sales and Marketing

- Outlook for commodity prices and impact on the company's plan

Management Strategy

- Variance analysis for cash flow and liquidity results
- How shortfalls in cash will be covered.

Forward-Looking Information

Acquisition of Reserves

- Budgeted exploration costs for next year
- Projected reserve additions over the next five years
- Exploratory prospect inventory over the next four years
- Estimated recoverable oil reserves, future production levels, and possible pipeline export routes being pursued
- Projected increase in proved reserves through additional drilling
- New gas field discovery and production potential
- Major project timeline—gross reserve potential

Extraction of Reserves

- Projected lifting costs by region for the next five years
- Drilling plans by major field
- Anticipated hydrocarbon production for the next five years split between liquids and gas
- Planned reduction of costs of developing deepwater wells through techniques learned in other foreign fields

Refining

- Capital spending plan and breakout of expected spending for each geographical area within E&P
- Start-up gas project, including estimated reserve quantities, ability of processing plant to be expanded at minimal cost, and intent to have a long-term presence
- Projected depreciation, depletion, and amortization cost by region for the next five years

Sales and Marketing

- Projected cash flow, oil production, and gas sales for the next five years

Management Strategy

- Management discussion of projects, previous years' goals and milestones, those not achieved, and those to be deferred to future periods
- Strategic plan for the global expansion of operations in the production of a major chemical product
- Description of the company's growth strategy, including geographical areas of focus, anticipated production growth rates, return on capital employed, finding and development costs, major projects, and so forth.

Information about Management and Shareholders

Nothing was found that represented unique and/or exceptionally useful information beyond information that is currently required or generally provided.

Background about the Company

Acquisition of Reserves

- Worldwide exploration activities and operations
- Increase in exploratory acreage
- Analysis of total reserve additions
- Exploratory drilling programs: maps used to describe geographic location of such activities

Management Strategy

- Formation of alliances to obtain maximum value.

Information about Unrecognized Intangible Assets

None.

Other Observations

- From an investor's perspective, this industry is very open with its disclosure of operating and financial data. Due to the competitive nature of the industry, individual product pricing data for chemicals and refined products are not disclosed. However, refined product and chemical prices, on an industry basis, plus oil and gas prices are published daily through independent public sources.
- Companies in the industry focus on providing relevant cost and volume data. As an example, most oil and gas companies disclosed their cost to produce a barrel of oil or a cubic foot of gas on a country basis. They also provided production volumes broken down country by country. This cost and production information, coupled with the public data mentioned above, allows analysts to model the companies and to prepare comparative analysis.

Pharmaceutical Industry

Aspects of the business that are especially important to the success of companies in the pharmaceutical industry include (a) research and development, (b) quality assurance, (c) management of revenue streams, (d) marketing and distribution, and (e) management strategy.

Business Data

Research and Development

- Description of products in development and product development agreements with strategic alliance partners
- Disclosure related to the development status of significant pharmaceutical products and anticipated development completion dates

Quality Assurance

- Discussion of the FDA approval process and status of specific products
- Discussion of clinical trial results

Management of Revenue Streams

- Discussion of government regulation and pricing constraints
- Discussion of impact of managed care and generic drugs
- Disclosure of sales by major product and product line
- Disclosure of the dollar amounts of rebates and discounts
- Disclosure of three-year sales numbers categorized by ailment being treated

Marketing and Distribution

- Discussion of customer base and potential total market for products
- Information about the company's sales and marketing teams, including number of experienced professionals, backgrounds, sales force productivity, and image
- Discussion of marketing alliances with other companies
- Disclosure of the number of physicians prescribing specific products, the total number of prescriptions written for specific products, and the number of patients currently being prescribed for specific products
- Disclosure of market share by product lines
- Disclosure of prescriptions written by week (including refills) for a specific product
- Discussion of current distribution channels and percentage of sales via major channels

Management Strategy

- Discussion of strategic differentiators: product strength, product opportunities, and capabilities to maximize future opportunities.

Management's Analysis of Business Data

Research and Development

- Discussion of the impact of technology on R&D expenditures and product research

Quality Assurance

- Discussion of the impact of product labeling changes on anticipated sales

Management of Revenue Streams

- Discussion of the risk of foreign currency exchange rate fluctuations on sales and profitability
- Discussion of the impact of generic drugs in the marketplace and their effect on specific brand name product sales

Marketing and Distribution

- Disclosure of the amount of annual sales related to newly introduced products
- Disclosure of a detailed table of revenue by products and services
- Discussion of expanding markets and product lines
- Discussion of the impact of changes in the sales force

Management Strategy

- Discussion of the three critical factors for the company's continued success: research "pipeline," new products, and alliances.

Forward-Looking Information

Research and Development

- Listing of promising compounds and the number of potential new products expected
- Listing of potential therapeutic areas and R&D activities within those areas
- Disclosure of the product lines in which R&D spending will be concentrated

- Disclosure of the status of specific pharmaceuticals currently within the R&D process
- Description of R&D activities within all product lines
- Disclosure of product pipeline and market size

Quality Assurance

- Disclosure of FDA approvals/nonapprovals of specific pharmaceuticals
- Discussion of difficulties in producing a product within industry manufacturing guidelines

Management of Revenue Streams

- Discussion of a product whose patent protection will expire and the potential impact on the product's revenue stream
- Chronological listing of products and their patent expiration dates
- Discussion of the potential future impact of generic drugs on "off patent" products
- Discussion of the regulated nature of the industry and the potential impacts this may have on future product pricing
- Discussion of the potential impact of competition

Marketing and Distribution

- A comparison of the number of people afflicted with certain diseases with the number currently being treated with effective drug products for those afflictions
- Listing of products, including those with expanded uses, those under regulatory review, and those in advance-stage development
- Disclosure of a company's plans to reduce reliance on royalties from alliances and expand sales and marketing activities to sell directly
- Disclosure of product marketing risks and the company's plans for international expansion
- Disclosure of the expected percentage of revenue over the next five years that will be generated from products introduced during the previous five years

Management Strategy

- Discussion of plans to use more external R&D and to investigate alliance opportunities
- Discussion of planned capital expenditures by product line
- Discussion of current sources of revenue from selling R&D that are expected to be depleted within the next few years.

Information about Management and Shareholders

Management Strategy

- Detailed description of executive management succession plans.

Background about the Company

Research and Development

- Disclosure of a company's product line focus
- Discussion of a company's R&D activities being supplemented by in-licensing, technological collaborations, joint ventures and acquisition efforts, including the establishment of research relationships with academic institutions and individual researchers
- Disclosure of the number of employees involved in R&D within a company
- Description of a company's significant strategic alliances
- Description of the process and key steps for obtaining new drug clearance from the FDA; other government regulations regarding manufacturing, packaging, labeling, and advertising

Quality Assurance

- Description of past product liability incidents
- Discussion of the company's history of product approvals and its management of the FDA regulatory process

Management of Revenue Streams

- Description of certain products that have had significant market share in their respective industry segments
- Discussion of the impact of patent protection and patent expirations within the industry
- Discussion of trends in the industry and their potential impact on the company's current and planned product lines
- Discussion of pricing pressures on surgical and pharmaceutical products that come from government initiatives as well as purchasing and operating decisions made by managed care organizations
- Discussion of the bargaining power of government and third-party payers
- Discussion of legislation in the industry related to mandatory usage of generic drugs

Marketing and Distribution

- Description of the company's product delivery channels
- Worldwide product overview with product category, brand name, description, and markets available categorized by segment
- Discussion of sales force

Management Strategy

- Discussion of the key drivers for short-term performance by business unit
- Discussion of significant acquisitions and their impact on the company
- Discussion of company's business strategies
- Discussion of company's "technology" strategy
- Discussion of company's restructuring decisions and the separation of R&D activities from the established pharmaceutical operations
- Discussion of the company's restructuring goals.

Information about Unrecognized Intangible Assets

Research and Development

- Detailed description of company's R&D portfolio
- Disclosure of the number of drugs currently in development
- Discussion of patent life for specific pharmaceuticals
- Discussion of company's strategic R&D alliances
- Discussion of global product approvals and clinical milestones
- Discussion by a certain company that it *does not* disclose all of the products in development at any particular time for competitive reasons

Quality Assurance

- Disclosure of patient citations versus competitors

Management of Revenue Streams

- Discussion of company's methodology for building brand names
- Listing of company-owned trademarks

Marketing and Distribution

- Disclosure of significant distribution alliances
- Discussion of the size and productivity of the sales force
- Disclosure of major brand names
- Disclosure of strong relationship with major retailers

Management Strategy

- Disclosure of the percentage of company's operations involved in strategic partnerships
- Discussion of company's reputation as "strategic ally of choice."

Other Observations

- Most disclosures about intangible assets were qualitative in nature. Disclosures that were quantitative related to research and development and patent lifespans. The types of intangible assets voluntarily disclosed included:

  - Brand names
  - Presence in geographic locations or markets (international versus domestic and number of sales personnel and their locations)
  - Physician relationships (number of prescriptions written)
  - Contracts (co-development, co-marketing agreements)
  - Formulas and processes (pharmaceutical research and formulations)
  - Research and development
  - Patents
  - Superior management or other key employees (executives and sales force strength)
  - Training programs and recruiting programs (sales force)
  - Favorable government relations (international relationships, FDA confidence).

- Disclosures about strategic alliances exceeded the requirements of GAAP and focused on the research, development, marketing, and distribution synergies provided by those alliances.
- A significant number of voluntary disclosures were made by each company concerning its individual products. The information disclosed was in sufficient detail to explain product history, expected lifespan, and future uses for each product or product group. Common disclosures included charts outlining the "product continuum" and the status of each significant product within this continuum. Common disclosures also included a listing of significant product patents and the expected expiration dates of these patents.

- In general, there was a relatively low number of voluntary disclosures related to product manufacturing activities (other than quality assurance). Possibly manufacturing efficiency and cost controls are of less importance to companies in the pharmaceutical industry. Standard manufacturing ratios and data (including inventory ratios and working capital formulas) were not discussed in depth by any of the companies. Sales dollars and sales growth were used as the primary indicators of product and product line performance.

Regional Banks Industry

Aspects of the business that are especially important to the success of companies in the regional bank industry include (a) loan growth and credit quality, (b) fee income, (c) operating efficiency, (d) capital management, and (e) management strategy.

Business Data

Loan Growth and Credit Quality

- Percentage of telemarketing calls that resulted in new product sales and percentage of customers receiving mailings or follow-up calls who applied for new credit cards
- The number of new credit card accounts, the increase in the lifetime value of a credit card customer, and an analysis of the average loss rate on credit cards compared with industry averages
- Various presentations of "managed results," which are the total of amounts for financial reporting plus amounts for off-the-books securitized portfolios; amounts reported include managed interest income, managed noninterest income, managed loan loss provision, managed charge offs, managed efficiency ratio, managed loans, managed delinquency, and managed volume

Fee Income

- The number of ATMs by state, the number of banking office locations by state, and the amount of deposits by state
- Use of a pie chart showing sources of noninterest income
- Disclosure that each customer used 5.8 different products, which is up from 5.5 the prior year

Operating Efficiency

- The reduction in full-time employees during the year and the number of full-time equivalent employees at year-end
- Overall efficiency ratio (noninterest expenses divided by total revenues) and the banking efficiency ratio (that is, without brokerage and investment banking activities)
- The percentage of noninterest operating costs "taken out" after integration of the operations of new acquisitions
- The number of banking customer service calls received and the percentage handled by interactive voice response units
- Productivity of consumer lending operations including percentage of loans approved using new technology, the percentage of loans approved "on the spot," and the percentage reduction in loan origination costs resulting from automation

- Personnel cost per employee
- Disclosure of the amount and the company's ranking in the industry for deposits per branch, which is a measure of productivity

Capital Management

- The average yield or rate for each asset and liability on the balance sheet (that is, income statement amount divided by the amount of the related asset or liability)
- Detailed disclosures on a line-of-business basis including the amount of capital allocated, a description of how capital allocation decisions are made, profitability, return on equity, and efficiency ratios
- Disclosures for lines of business including detailed balance sheets and income statements

Management Strategy

- Disclosure of the number of households added as customers as a result of mergers.

Management's Analysis of Business Data

Loan Growth and Credit Quality

- The credit card retention rate in situations in which customers were initially seeking to close their accounts

Fee Income

- Comparison of growth rates for fee income, total revenues, and operating income for recent periods
- Disclosure of the percentage of overdraft checks paid, the percentage of fees waived, and credit approval rates
- Disclosure of the compound annual growth rate (five years) for non U.S. customers' assets under management and a breakdown thereof between internal growth and new customers
- Disclosure of the effect on fee revenue if equity values increase or decrease 10 percent and if bond prices increase or decrease 10 percent

Operating Efficiency

- A disclosure that backs out merger-related expenses from income statement items to show "recurring" income; disclosure of merger-related expenses that did not qualify for recognition in the current year and that will hit future periods
- Use of bar graphs to illustrate trends in charge offs, operating expenses, efficiency ratio, interest income, fee income, EPS, net income, ROA, and ROE

Capital Management

- An analysis of year-to-year changes for the company vis-à-vis a group of peer banks for the following ratios: ROA, ROE, efficiency ratio, fee income as a percentage of total revenue, the percentage contribution of retail and commercial banking to total income, and EPS
- Key performance measures for the company as compared with the 25 largest banks regarding assets, net income, ROA, ROE, equity/assets, nonperforming assets, loan loss coverage information, overhead ratio, and S&P credit ratings

Management Strategy

- A discussion about key challenges to the banking industry including moderating loan growth, competitive pricing and narrowing margins, credit quality concerns, expense pressures, and the need for investment in technology.

Forward-Looking Information

Capital Management

- Disclosure of targeted performance goals for growth in ROE, ROA, EPS, and the dividend payout ratio
- Disclosure of planned growth in profit contribution by line of business for the next two years
- A caution that future earnings are not likely to equal current-year earnings and that future earnings are more likely to return to long-term historical performance
- Projected five-year earnings growth for the company versus peers
- Disclosure of percentage growth goals for revenue, EPS, and ROE by line of business for two years; also, efficiency ratio goals by line of business

Management Strategy

- A description of the factors that will affect future revenues including savings rates, value of worldwide markets, interest rates, volatility of currencies, pace of pension reform, pricing/competition, and technological change
- Description of strategic plans for growth broken down by lines of business.

Information about Management and Shareholders

Nothing was found that represented unique and/or exceptionally useful information beyond information that is currently required or generally provided.

Background about the Company

Management Strategy

- Description of economic growth rates in population, in nonagricultural employment, and in personal income in the company's market areas
- Description of strategic initiatives (branch campaign, customer service network, sales strategy, and financial advisory strategy) to increase services provided to individual customers
- A discussion of how the company's business success is highly dependent on continued technological advances together with a description of seven new software systems now being used for various customer activities
- A description of the company's strategy for acquisitions.

Information about Unrecognized Intangible Assets

None.

Textile—Apparel Industry

Aspects of the business that are especially important to the success of companies in the textile—apparel industry include (a) brand recognition and revenues, (b) cost control and inventory management, and (c) management strategy.

Business Data

Brand Recognition and Revenues

- Disclosure that a company sells to several thousand accounts, but more than 80 percent of product was sold to mass merchandisers and major discount chains
- The percentage of total sales attributable to the company's 10 largest customers
- A market overview of key products, brand review by distribution channel, and market share per brand

Cost Control and Inventory Management

- Disclosure of the percentage of garments sewn offshore
- The increase in the number of units of apparel production capacity over a five-year period; also, the reduction in the number of partners in the company's factory vendor base

Management Strategy

- Acquisitions that move the company into private label womenswear in retail mass market
- Management reduction of the risks of import business by placing import programs with suppliers in many countries
- Description of company's "investment in modernization" plan to achieve double-digit increases in productivity through automation
- Establishes a target debt to capital level below 40 percent.

Management's Analysis of Business Data

Brand Recognition and Revenues

- Report of net sales by product class and also the percentage of menswear and womenswear
- Disclosure of the company's domestic market share of various product lines with comparisons to competitors

Cost Control and Inventory Management

- Discussion of productivity goals and manufacturing changes

Management Strategy

- Company continues to focus on more select customer base.

Forward-Looking Information

Brand Recognition and Revenues

- Assessment of plans for worldwide growth, increased sales, and competitive market conditions in a variety of report locations; identification of potential amount of increase in apparel sales due to growth initiatives in Mexico
- Discussion of "Future Operating Results" including sales trends for coming year and estimated liquidity
- Details of "media spend" provided; amounts are to triple over three years

Cost Control and Inventory Management

- Reduction in the number of styles to be manufactured and increased use of computer-aided design technology are expected to contribute 25 percent improvement in design cycle times
- Goal for annual savings through business re-engineering as part of seven-year plan

Management Strategy

- A detailed plan to transform the "company into a more competitive organization that would ultimately post more consistent and predictable financial results."

Information about Management and Shareholders

- Employment of compensation consultants to evaluate performance and compensation of top management. Return on net assets established as target scheme for group and corporate executive compensation.

Background about the Company

Cost Control and Inventory Management

- Description of company’s goals to decrease cycle time by 25 percent, reduce unit shipping costs by 25 percent, and increase productivity by 30 percent through state-of-the-art technology
- Discussion of multi-fiber agreement, Agreement on Textiles and Clothing (ATC), and related US quotas that restrict use of overseas sources; more liberal ATC agreement in future would benefit company’s Caribbean operations [Dominican Republic]; domestic sewing facilities were closed in three southern states; Honduras and Mexico facilities were opened on a lease basis; the company has 10 US plants and operations in 5 foreign countries
- Web site that provides a tour of production facilities and explains quality control processes
- Disclosure that the company is moving plants out of Western Europe due to high labor costs; over half of sewing of products sold in the United States has moved to Mexico, the Caribbean and other cost efficient locations; the percentage will increase in coming years to offset rising labor costs and combat continued pricing pressures

Management Strategy

- Historical information dating to the company’s formation, international operating information by country, views and policies on environmental matters, and corporate guiding principles explained as context for a statement about the future of the company including extensive discussion of issues such as trade barriers, worldwide competition, and changes in the industry
- A history of the company well-told through a series of key events including current ones; this perspective assists in developing an understanding of the business and its complex related party transactions.

Information about Unrecognized Intangible Assets

- 97 percent consumer brand awareness that represents powerful recognition of company’s trademark strength
- A statement that “our brands are our most valuable properties, our primary means of signaling the uniqueness, value and quality that make us worth the consumer’s attention”
- A statement that “although the company is not dependent upon any single license. . . . It believes its agreements in the aggregate are of significant value to its business”; target stores will exercise option to purchase key label and certain licenses [11 percent of profits and sales] expire next year and will not be renewed

- Statements that powerful brands and trademarks provide the company with stability, and technology know-how in a proprietary inventory management system allows the company to manage store by store inventory consistent with aggressive rollout of merchandise.

Other Observations

- Relatively few notable disclosures were found. Several of the companies studied represent traditional ownership patterns of family influence and control, and their disclosure and communication practices may be considered more proprietary and compliance driven.