The Impact of XBRL on the Audit Process

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Abstract

eXtensible Business Reporting Language (XBRL) is a method of tagging financial accounting data that has far-reaching effects on nearly all aspects of accounting and auditing. This paper describes the steps involved in creating XBRL financial statements and further discusses how these steps provide additional risks in financial statement disclosure. Additional insight is given into how the auditing process can be expanded to accommodate these risks.

Introduction

eXtensible Business Reporting Language (or XBRL) is a means by which business information, both financial and non-financial, is communicated electronically. It has the potential to provide enormous benefits to the investing community by reducing data redundancy, increasing accuracy, and streamlining transmission among various domains, media, and users. While XBRL does provide great promise, it also brings changes and challenges that require attention from the accounting and auditing communities.

Prior to the mandated use of XBRL for SEC filings, the Securities and Exchange Commission allowed companies to file XBRL financial statements within a voluntary filing program (VFP). These filings were not required to be audited. At the same time, these filings give some insight into the steps involved in filing XBRL documents and the burden placed on filing companies. The voluntary filings also provide insight into errors or risks arising from the use of XBRL.

On 10 February 2009, the SEC published in the federal register a rule by which companies would be required to file their financial data using XBRL (SEC 2009). The rule becomes effective on April 13, 2009.

The rules will apply to public companies and foreign private issuers that prepare their financial statements in accordance with U.S. generally accepted accounting principles (U.S. GAAP), and foreign private issuers that prepare their financial statements using International Financial Reporting

Standards (IFRS) as issued by the International Accounting Standards Board (IASB). Companies will provide their financial statements to the Commission and on their corporate Web sites in interactive data format using the eXtensible Business Reporting Language (XBRL). The interactive data will be provided as an exhibit to periodic and current reports and registration statements, as well as to transition reports for a change in fiscal year (SEC 2009).

Interactive data financial requirements will be phased in beginning in 2009. Five hundred large companies will be required to provide interactive data reports starting after June 15. Other companies using GAAP will be required to file with interactive data over the next two years. Companies reporting in International Financial Reporting Standards as issued by the International Accounting Standards Board will be required to provide their interactive data reports starting with fiscal years after June 15, 2011. Further in 2011, the SEC will require mutual funds to begin including data tags in their public filings that supply investors with such information as objectives and strategies, risks, performance and costs.

Since XBRL is a mandate from the SEC, questions have arisen about the audit implications of such filings. A number of authorities have posited that XBRL will have little, if any, impact on the audit. Specifically, in the mandate the SEC does not believe that auditor involvement is necessary with respect to the interactive data file. They further indicate there is no additional basis for auditor liability based on data tagging. Also, an auditor will not be required to apply AU Sections 550, 711 or 722 to interactive data provided in an exhibit or to the related viewable interactive data (SEC2009).

The SEC's position partially rests on the expectation that preparers of tagged data will take the initiative to develop practices to promote accurate and consistent tagging. While the process used to generate XBRL tagged financial statements is relatively straightforward, the process itself introduces additional financial reporting risks. Indeed, the evidence to date suggests that the risks may be significant. Accordingly, to promote accurate, consistent tagging and mitigate risks associated with the tagging process XBRL knowledge and skills must be developed and incorporated into the audit plan.

The remainder of this paper is organized as follows. The next section provides an overview of the XBRL organizational structure and the steps involved in generating XBRL-tagged financial statements. The following section describes how these steps may introduce risk into the reporting process. Also presented is a review of literature describing the errors and inconsistencies found in XBRL filings to date. Recommendations are then made as to how the audit process could be expanded to mitigate these risks.

Overview of XBRL

XBRL International is comprised of local jurisdictions which focus on the progress of XBRL in their region. XBRL US is a local jurisdiction of XBRL International - a not-for-profit consortium of approximately 500 companies and agencies worldwide working together to build the XBRL language and promote and support its adoption. The mission of XBRL US, Inc. is to support the implementation of XBRL in the United States through the development of taxonomies relevant for use by US public and private sectors, working with a goal of interoperability between sectors, and by promoting adoption of XBRL through the collaboration of all business reporting supply chain participants. Taxonomies are the foundation of XBRL enabled reporting (XBRL US).

XBRL is part of a family of "eXtensible Markup Languages" (XML) that provides a standard means of communicating information electronically between businesses and on the internet (XBRL International). To accomplish this goal, each disclosure item (e.g. each number in the financial statements) is assigned an electronic tag. These tags are standardized and published in taxonomies according to standards established by XBRL International and XBRL US.

Documents created and rendered from taxonomies are called instance documents. A company's set of annual financial statements is an example of an instance document. Two areas of taxonomy development that immediately affect accountants in the United States are the XBRL Global Ledger (XBRL-GL) taxonomy and the US-GAAP taxonomy. Both taxonomies are being developed into mature and robust applications. The U.S. GAAP project was initiated by the Securities and Exchange Commission (SEC) and has undergone substantial change since 2005. The SEC released the latest XBRL US developed taxonomy in March 2009.

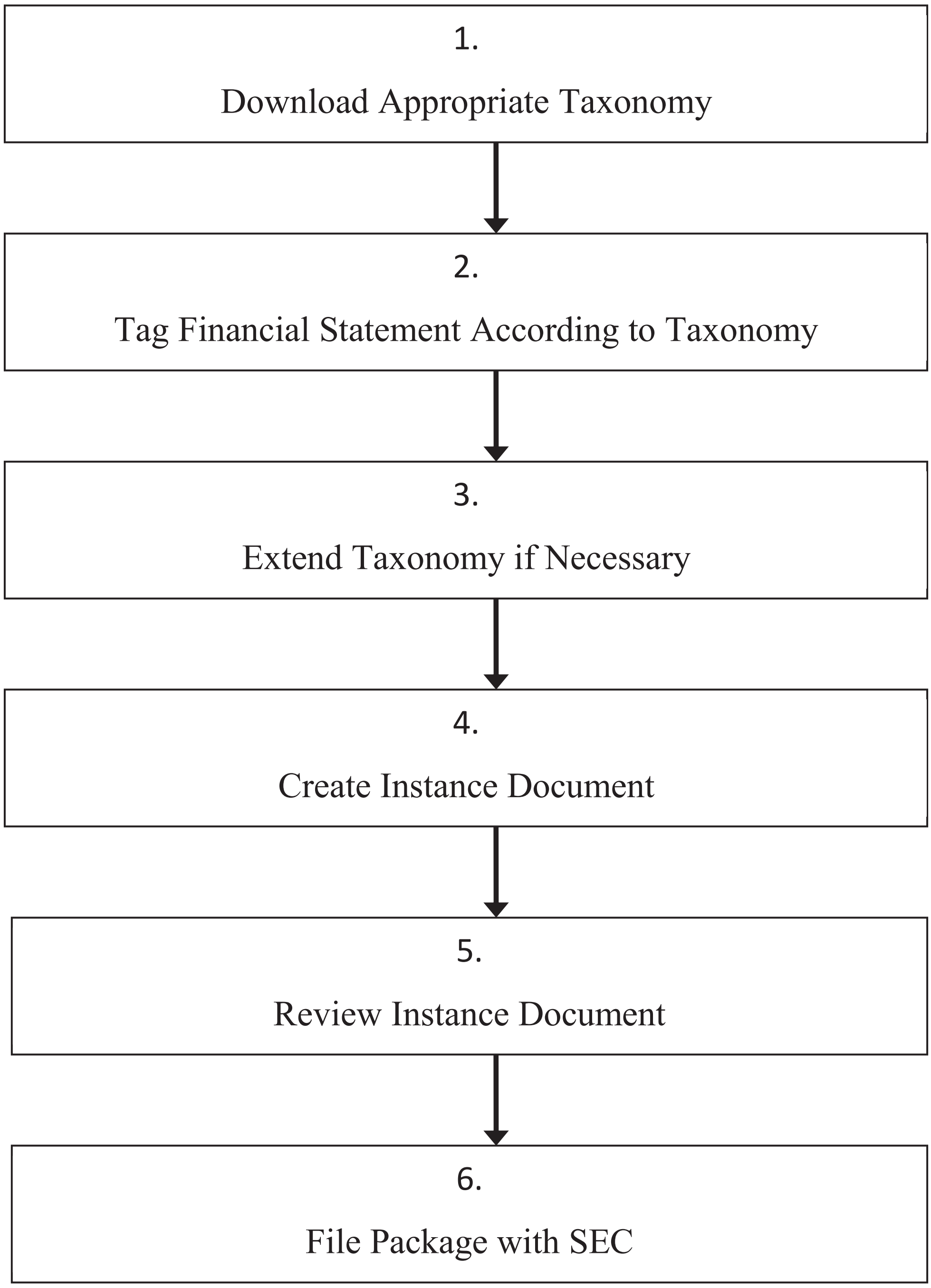
The steps involved in filing XBRL financial statements are shown in Exhibit 1. Each step is described below:

1. Download the Appropriate Taxonomy: A taxonomy is a dictionary of terms available for tagging financial data. In order to file with the Securities and Exchange Commission, taxonomies must be approved by XBRL International and are available for download from that organization's web site.
2. Tag Financial Statement According to Taxonomy: Tagging data involves the use of software, such as that listed at XBRL International (http://www.xbrl.org/TechSupport/). In order to tag the data properly, the user must be familiar with the taxonomy, the tagging software, and the underlying financial accounting data. The

knowledge of accounting data is important to assess the proper tag (or tag extension) required.

3. Extend Taxonomy if Necessary: At times companies face situations where they have financial statement information that does not "fit" into one of the available tags in the taxonomy. In these situations, the company can "extend" the taxonomy by creating a newly-defined tag. Additionally, table type data contained in disclosures such as Debt will require taxonomy extensions.
4. Create Instance Document: The instance document is an XML file containing the "tagged" financial data. This file along with any company specific extensions to the taxonomy is submitted to the SEC.
5. Review Instance Document: The instance document must be reviewed for completeness and consistency prior to filing.
6. File Instance Document: Once the financial information has been tagged and reviewed, it is ready for filing with the SEC. The package of information sent to the SEC will consist of an XML document as well as all appropriate linkbases if there is a company specific extension to the taxonomy.

Exhibit 1
The XBRL Tagging and Filing Process



Risks Introduced by XBRL

Under the VFP, the XBRL data did not have to be audited. Similarly, under the mandate audits will not be required. While it is difficult to predict the future, it would be prudent to plan for some level of assurance in the future. Auditors must therefore consider what impact XBRL has on the audit process.

The process for tagging financial data is straightforward, but the process does present the possibility of risks. Auditors must be aware of the nature of possible risks and how to adapt audit processes to address these risks. Upon review of the XBRL process, the following risks appear most likely:

- Consistency – One benefit of XBRL is the ability to compare financial data across companies and across time. Because XBRL requires the issuer to place financial data into specified categories (i.e., tags), there are risks that (1) tagged data could indeed be categorized differently than the accompanying financial statements, (2) different companies could tag similar financial data with different tags due to user interpretation and/or error, or (3) the same company could tag financial data differently year-to-year.
- Taxonomy Extensions – A strength of XBRL is the use of extensions, when necessary. That is, users can create their own tags when the current taxonomy is not deemed to have one appropriate for the data being tagged. Extensions create potential problems because they introduce the possibility of lack of comparability across companies. Also, the need to create an extension is subject to user interpretation, and there is the possibility that an extension could be defined incorrectly.
- Incorrect Tags – The risk is always present that financial data could be tagged incorrectly, resulting in disclosure risk for the issuer.
- Conformity to XBRL Specifications – The SEC requires companies to use taxonomies that conform to appropriate specifications (e.g. XBRL Specification v2.1) and likewise, any extensions must conform to such specifications.

While these risks are possible, some auditors may see them as highly unlikely and/or immaterial in nature. Fortunately, the Volunteer Filer Program gives some insight into these risks.

Boritz and No (2008) and Chou (2006) examined the filings from the VFP and discovered a number of errors. For example, all of the filings in the

VFP contained taxonomy extensions. In a number of situations, the XBRL filing did not agree with the accompanying financial statements. Numerous companies had inconsistencies between years, and approximately 66% of the instance documents failed validation tests, indicating errors or exceptions between the instance document and the XBRL specifications. Interestingly, these validation failures actually increased over time.

Admittedly, many errors and inconsistencies noted by these researchers may be immaterial in nature. At the same time, however, some of them may indeed present significant problems and should be noted as such by the auditor. Furthermore, the taxonomies used in the VFP did not have tags for disclosures such as MD&A and footnotes. Footnote disclosures were incorporated in the release of the December 7, 2008 taxonomy. The SEC is phasing in the tagging of disclosure data. The phase-in will utilize "Block Tags," then subsequent filings will require the full detail of the disclosure. Block-tagging means all text and data for a disclosure will be associated with a text block element in the taxonomy for the disclosure. Once detailed disclosure tagging is required by the SEC, the possibilities of errors and inconsistencies will be heightened significantly.

Expanding the Audit Process

XBRL has the potential to introduce risks into the financial reporting process, and the evidence to date suggests that such risks are, and will be, present in XBRL filings. At some point in the near future, auditors will be called upon to provide some level of assurance on XBRL filings. Therefore, auditors must adjust their audit processes to address XBRL risks. Generally, the audit process should follow the XBRL process itself and address the risks at each stage, as described below:

1. <u>Download the Appropriate Taxonomy</u>: The auditor must provide assurance that the proper, approved taxonomy was used.
2. <u>Tag Financial Statement According to Taxonomy</u>: This stage of the audit process presents the greatest number of risks, such as incorrect tagging, year-to-year inconsistencies, etc. While the auditor cannot perform the actual tagging, it may be worthwhile to review the detail of the most financially material items. Also, it would be advisable to use an approved XBRL reader to highlight any areas of inconsistencies.
3. <u>Extend Taxonomy if Necessary</u>: All extensions should be reviewed for necessity and conformity to required standards. Also, a review of extensions used in prior years would be a useful check for inconsistencies.

4. Create Instance Document: The creation of the instance document could present technical errors and must be reviewed accordingly.
5. Review Instance Document: The auditor should be aware of the nature of this review and any software used to perform validation checks.
6. File Instance Document and Taxonomy: This is another stage where technical errors could be introduced. The auditor therefore should review the filed document. Also, as noted by the PCAOB (2005), the auditor should secure a representation letter from management stating that the XBRL filing is in accordance with SEC requirements.

The auditor must adjust the audit process to address the described risks. XBRL has other effects on the auditor, as well. For example, the auditor(s) must have significant training. The translation of financial statement information into an XBRL instance document is the end point in a complicated process. Successfully creating an XBRL document involves training and proficiency in XBRL. Therefore, audit personnel must be familiar with (1) the current US-GAAP taxonomy, (2) the general XBRL reporting steps as outlined in Exhibit 1, and (3) any XBRL tools used to create an instance document (Merrill 2007).

XBRL heightens unique independence questions regarding auditor assistance and potential violations of independence. The PCAOB (2005) noted that independence rules used in the creation of an organization's financial statements apply equally to the creation of XBRL instance documents. However, the auditor may provide technical guidance when other appropriate sections of AT 101are in place.

Summary and Conclusions

XBRL is progressing into a mainstream application for financial reporting, largely due to SEC initiatives such as the mandate to provide XBRL filings. Also, the SEC recently announced that EDGAR will be replaced with IDEA, the Interactive Data Electronic Applications system, which will rely on XBRL.

The advantages of an XBRL reporting scheme are apparent, and soon all companies will require this form of interactive reporting to meet governmental reporting requirements (Barron 2007). Additionally, XBRL and the accounting standards setting process may merge. According to Robert J. DeSantis, President & COO of the Financial Accounting Foundation, "XBRL financial reporting taxonomies may become an integral component of the financial accounting and reporting standard-setting process as users become more accustomed to relying on XBRL based financial reporting" (Heffes 2007).

The proliferation of XBRL has dramatic and distinct implications for the auditing profession, and auditors will be required to adjust their processes accordingly. Furthermore, auditors will be required to master XBRL terminology, taxonomies, and tools. Auditors who gain an early and in-depth understanding of the audit implications of XBRL will undoubtedly have a strategic competitive advantage in the assurance marketplace (Watson 2007).

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