XBRL — Will It Change the Paradigm?

S. Securities and Exchange Commission (SEC) Chairman Christopher Cox has set a path towards a revolution in financial reporting. He has propelled the implementation of worldwide accounting information unification through his efforts to encourage the development of eXtensible Business Reporting Language (XBRL) “tags.”

While they may now appear to be an extra layer of technology, XBRL tags will allow individuals and analysts to access published financial reports on a consistent basis, with the ability to improve analysis. However, XBRL will do much more. By creating a common electronic definition for every accounting transaction, XBRL will allow for advancement in internal financial reporting and analysis by companies. Furthermore, I believe these tags will result in a paradigm shift in auditing — even though no more than about 40 companies are involved in the voluntary XBRL Filers Program.

The SEC initiatives and funding for XBRL (it committed $5.5 million toward writing XBRL taxonomies in September 2006) are related to designing the tags for financial reporting data. As Cox has said, “What we need is something that will give individuals faster access to better information that they can easily use and understand. We need to make searches for information easier.”

In its voluntary program, the SEC has asked companies to voluntarily tag their financial statement presentation data. The commission has also created a viewer on its website so that, for financial statements filed with the SEC, users of financial statement information can access that data in an enhanced way to see the benefits of XBRL. Once the data has been tagged, the user can compare various filers’ information via the XBRL viewer. You should take a look at this tool at www.sec.gov/spotlight/xbrlxbrlwebapp.htm.

So, a number of companies are voluntarily tagging their data, demonstrating the usefulness of the XBRL technology — but this still isn’t revolutionary! That’s because during this period, the companies/filers must prepare their financial statements using their normal systems and then tag the data using one of the various products or software from vendors assisting with the tagging process. Furthermore, they are only tagging at the financial statement level.

I refer to this as the “bolt on” approach. However, XBRL is a foundation technology capable of being integrated into financial systems. I am enthused about XBRL because in the future, XBRL tags will be accessed via tables in automated financial applications. In this later phase, XBRL tagging will become transparent to the user, after an initial setup phase for various types of transactions.

I lived through a similar implementation period for a foundation technology in the wholesale retail supply chain. Here, the technology was known as electronic data interchange (EDI). Prior to the 1980s, vendors and retailers did not take advantage of computers to exchange valuable supply chain data. For example, the retailer knew what was sold, but offline analysis caused delays and inaccuracies in the reorder process. Wal-Mart and other top retailers laid out plans to exchange data on a real-time basis, using commonly formatted purchase orders, invoices and other electronic documents. This would provide similar efficiencies, lowering labor costs, reducing inventory and better ensuring products were available at the point of sale.

EDI went through a bolt-on period, too, while standards and systems were being developed. I recall what I called at the time “fake EDI.” If you wanted an order from a fully EDI-compliant retailer, you could receive it on a stand-alone PC system that ran an EDI application. This PC application gave the appearance that you had a fully integrated EDI system. Back then, you received the order on the PC and walked it over to order entry. As you built or purchased fully compliant EDI systems, however, you didn’t need an order-entry department. You were passing from the bolt-on phase to the highly efficient EDI stage, and productivity and inventory management reached new heights.

Tags Will Boost Financial Reporting, Too

The same will hold true for XBRL. Once the various enterprise software vendors such as SAP, Oracle and others build the XBRL tags into their systems, the tags will be available for improvements in internal financial reporting, too. Tagging will be transparent to the user, and productivity gains will follow. More importantly, better financial analysis will lead to better management decisions.

For decades, we have been looking for a way to change the audit model. Given the real-time data processing accounting environment, the backward-looking audit approach has come under some strain. For example, how do you audit wire transfers and other significant financial transactions months after they have taken place?

The assurance portion of the accounting profession has been looking for the technology to implement continuous auditing and monitoring. XBRL will provide the base technology that will allow the expansion and revolutionize the assurance practice. I believe Chairman Cox shares this vision.

So, why get involved now? It is critical that effective tags that will work for all industries are developed. The FEI member companies that volunteer will be a critical part of the quality assurance process.

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