

XBRL reporting risk and the role of internal audit

At a glance

Companies that have been submitting XBRL reports for the past two years are no longer covered by the SEC's modified liability provisions for XBRL.

XBRL reporting is within a company's disclosure controls and procedures.

Internal audit functions should consider ways to help their organizations address XBRL reporting risks and improve supporting processes.



Addressing the risks in XBRL reporting

June 30, 2011, was a significant milestone in the Security and Exchange Commission's (SEC) Interactive Data program, an effort to streamline the delivery of financial information by leveraging the power of eXtensible Business Reporting Language (XBRL). As of that date, virtually all SEC registrants reporting under US GAAP were required to submit their financial statements in the XBRL format.

What is XBRL?

XBRL is an Internet language designed to enhance the electronic sharing of business information by making financial reports "computer-readable." XBRL uses tags (codes) to describe and identify each piece of data in a financial report. The tags allow computer programs to sort through the financial data, quickly analyze relationships, and generate output in various formats. Because the tags are standardized, information from different companies can be easily compared.

The US GAAP taxonomy is a library that defines all standard tags used for individual items of data. Periodically the Financial Accounting Standards Board updates the taxonomy, and then the SEC approves it for use.

Under the SEC's phase-in requirements, the largest companies began providing XBRL information in 2009. Another group began in 2010 and the remainder in June 2011. As of today, all public companies that report in US GAAP are required to comply with the SEC's XBRL mandate. After going public, companies are required to begin complying with the XBRL requirements in their first quarterly filing on Form 10-Q.

To date, most companies are able to begin complying with the XBRL mandate by applying what is often referred to as "block-tagging." Under block-tagging, a tag is applied to each individual number found in the primary financial statements as well as each financial statement footnote, taken as a whole (i.e. 'block of text.')

Then companies move to the more complex "detail-tagging" where, among other requirements, tags must be applied to each individual number appearing in the footnotes. Many companies see an increase in the number of tags used from 200 to more than 1,000 when they move to detailed-tagging. For some complex sets of financial statements, there can be more than 10,000 individual tags in a detailed-tagging submission.

Who uses XBRL?

Anyone who uses financial information is a potential user of XBRL, including investors, analysts, and lenders. Because XBRL tags allow computers to perform much of the analysis, users of XBRL-tagged information can efficiently and effectively evaluate a vast amount of financial reporting information provided by companies. This could include simple tasks like auto-populating an analytical spreadsheet, to more complex tasks like sorting through vast amounts of data to identify unusual trends in the information.

To date, the most visible user of XBRL-tagged data has been the SEC. In executing its responsibility to periodically review company filings, the SEC uses XBRL to sort through large amounts of reported data, identify anomalies, and investigate potential missing or inaccurate disclosures. The SEC expects XBRL-based analysis to be a more powerful and more efficient tool than the traditional manual, paper-based review process.

XBRL-related risks

Users of XBRL information expect the XBRL files to completely and accurately represent the information contained within the traditional financial statements. As such, the primary risk associated with XBRL is providing data that is inconsistent with the corresponding financial statements. Typical risks include incorrect tagging, inconsistencies in amounts, and missing data.

A secondary risk is that the XBRL-formatted information will fail to comply with the complex rules contained in the Edgar Filer Manual. Other risks associated with XBRL filings include missed filing deadlines because of the added effort required by XBRL and failure to safeguard confidential information (when utilizing outside service providers).

In response to concerns expressed by companies over the potential liabilities associated with inaccurate XBRL submissions, the SEC granted companies a two-year modified liability period with respect to their XBRL submissions. Under this provision, a company would, among other limitations, not be liable for inaccuracies in its XBRL submissions if the company made a good faith effort to comply and promptly corrected the failure after becoming aware of it. For the largest companies that began providing XBRL information in June 2009, the modified liability period ended with their 10-Q filing for the September 30, 2011, quarter. Most other companies will see their modified liability period end either September 30, 2012 or 2013, depending on when they first started providing XBRL information. However, the modified liability period will expire after October 31, 2014, for all companies.

The XBRL quality challenge

Our experience working with a variety of companies indicates that many face significant challenges in achieving their XBRL quality objectives. When engaged to assist a company in assessing the quality of an XBRL submission, we often find numerous errors and omissions. Sometimes the errors are minor inconsistencies with the Edgar Filer Manual. However, we also find more significant mistakes, including omitting entire disclosures, such as the financial statement exhibits, or incorrectly representing debits as credits and vice versa.

Our observations are consistent with those of the SEC. To give companies an understanding of where errors most commonly occur, the SEC's Division of Risk Strategy and Financial Innovation has published its observations from reviews of XBRL submissions, the most recent being published in June 2011. The observations can be accessed at <http://www.sec.gov/spotlight/xbml/staff-review-observations-121311.shtml>.

How internal audit functions can help

An internal audit organization can help its company understand the risks associated with XBRL by evaluating whether these risks have been appropriately addressed, whether the process is producing high quality XBRL submissions, and ultimately how to improve the XBRL process.

To start, internal auditors should determine where the company is in the XBRL implementation process. For example, auditors should understand whether their company is still submitting reports under modified liability provisions and when the modified liability provision expires. We find that companies are increasingly asking internal audit organizations to assess the companies' response to XBRL-related risks in advance of the expiration of the modified liability period.

Next, the internal audit function can take steps to understand the reporting process and how XBRL risks are currently being addressed. Initially, most companies outsourced the preparation of their XBRL submissions, often to their financial printers. This solution provided companies ready access to needed XBRL technical skills. However, as with any outsourced activity, an organization still needs to monitor the service provider and provide appropriate oversight and review. Also, the accurate preparation of an XBRL submission requires close collaboration between the XBRL experts and the individuals in the organization who are most familiar with the financial reporting disclosures.

As familiarity with the XBRL requirements grows, an increasing number of companies are moving the XBRL process in-house, often through new technologies. The change affects how a company creates its XBRL submission and requires a higher level of XBRL knowledge within the company. The change may also affect the process for creating traditional financial statements. Internal auditors will likely want to understand risks associated with this change, such as how needed XBRL skills are developed, or the risks related to the technology implementation.

The design and operating effectiveness of XBRL-related controls is another area where internal audit can play an important role. We often find that XBRL-related controls are less formal than other financial reporting controls and are typically not fully documented. While XBRL-related controls are not within the scope of Sarbanes-Oxley Section 404, the controls do fall within the Disclosure Controls and Procedures of Sarbanes-Oxley Section 302 and often require some level of documentation and assessment.

The internal auditor should also understand the role of the independent auditor in evaluating the XBRL submission. Unlike other sections of the periodic filing, XBRL-formatted information does not have to be read or commented on by a company's external auditor; auditor involvement is optional under the SEC's XBRL requirements. So, unless the company makes a separate request, its external auditor would typically not look at the XBRL information. However, we are seeing an increasing interest by companies to engage the external auditor to perform agreed-upon procedures related to the XBRL submission. These engagements are typically executed under AICPA Statement of Position 09-1 (SOP 09-1), *Performing Agreed-Upon Procedures Engagements That Address the Completeness, Accuracy, or Consistency of XBRL-Tagged Data*.

Additionally, the internal audit organization can bring value-added ideas on how to improve the XBRL process. While many companies struggle with high-cost, low-quality XBRL processes, others have found ways to leverage the opportunity of XBRL to drive significant improvements throughout their financial reporting processes.

How PwC can help

The requirements of XBRL are new and complex.

PwC has extensive experience working with dozens of companies to understand and respond to the risks of XBRL, including assessing their quality of XBRL submission and evaluating their supporting XBRL business processes. We bring to each engagement an established process and controls framework that we tailor to the organization's specific implementation. Our approach is designed to provide concrete recommendations to improve the quality and efficiency of your process.

To discuss this issue, contact:

John Clements

Partner

Office: (408) 817-3990

john.clements@us.pwc.com

Jennifer Neglia

Director

Office: (267) 330-2915

Jennifer.neglia@us.pwc.com

Ravianand Suryanarayan

Director

Office: (408) 534-2387

ravianand.suryanarayan@us.pwc.com

pwc.com