XBRL

Will the auditing profession embrace XBRL for governance, risk management, and compliance as the accounting profession has begun to do?

By John Chironna and Ernst Zwikker

On April 13, 2009, in an effort to improve the usefulness of financial statements to investors, the Securities & Exchange Commission (SEC) adopted rules requiring public companies to provide their financial statements to the Commission and on their corporate websites in interactive data format using eXtensible Business Reporting Language (XBRL).

The auditing profession has raised liability concerns that users of financial statements in XBRL format may incorrectly assume that auditor assurance has been provided on the data tags that make up a financial statement in XBRL format. These audit firms recommend that the standard audit report clarify the extent to which the audit extends to XBRL data. The SEC has addressed this concern by stating that issuers aren't prohibited from disclosing the degree of auditor involvement in the XBRL data.

Although the auditors' preemptive concern about liability has some merit, we take a broader view of XBRL and the potential of this standard for compliance and financial audits. Could the audit profession benefit from XBRL—i.e., could XBRL have an impact on the level of audit risk? Or could it affect detection risk?

Considering that most management accountants are exposed to a company's internal and external audits, they can benefit greatly from an understanding of how XBRL can facilitate improved efficiency and accuracy of various audit procedures.

Data Formats for Auditing

Public companies are filing their financial statements and various forms (such as the 10-K and 10-Q) with the SEC via its Electronic Data Gathering Analysis and Retrieval System (EDGAR) (and its next-generation EDGAR for filing XBRL-tagged interactive data files). The processes of electronic filing began in 1993, and, since then, companies have been required to file their financial statements in American Standard Code for Information Interchange (ASCII) or HyperText Markup Language (HTML). ASCII, a widely used standard for encoding text documents on

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computers, is often used when transferring files between computers. HTML was designed to display data, say, for example, on a Web page.

What has this meant for the audit profession since financial statements of issuers are available in ASCII or HTML format? Auditors have made limited use of the digital format of the financial statements whether in ASCII or HTML format. Instead, they rely primarily on printed documents. They might use Computer-Assisted Audit Techniques (CAATs) to execute substantive procedures when financial statements are available in a digital form. Most standard CAAT solutions work with character-delimited ASCII files because of ASCII's characteristics for data transfer, but data in HTML format is of little use for standard CAAT solutions. Also, the data in financial statements is an aggregated form of accounting data. For testing transactions, account balances, and internal controls, auditors rely on the underlying, nonaggregated accounting data stored in the issuers' financial system or enterprise resource planning (ERP) system.

What could the audit profession have done with the available financial statements in ASCII or HTML format? Auditors could use character-delimited ASCII files to have companies' financial statements available on their computer and import them to a spreadsheet program. This digital format helps when conducting standard analytical audit procedures—i.e., preliminary analytical procedures, substantive analytical procedures, and final analytical procedures. Preliminary analytical procedures are performed to better understand the business and to assess business risk. Substantive analytical procedures are

performed to obtain evidence about assertions related to account balances. And final analytical procedures are performed as an overall review of the financial information in the final state of the audit.

But the use of digital data hasn't taken off within the audit profession the way it has transformed how issuers file with the SEC. First, there's a widespread misperception within the audit profession that automated audit procedures require a large upfront investment and are more expensive than manually performed audit procedures. There's no basis to this argument, which is shared among senior audit professionals, many of whom were never formally trained in or exposed to the capabilities and ease of information technology for the audit profession. This same misperception was evident when we talked with various groups of accounting students at the University of Connecticut about this same issue. Therefore, unless they are taught differently, this next generation of auditors will probably be averse to using information technology as a means to improve conventional audit techniques, citing complexity of programming and cost as the reasons.

Second, obtaining the data needed for CAAT requires the cooperation of the IT department. Many IT professionals are still from the traditional school of thought where database administrators were expected to defend and protect access to the systems they maintain. Also, most auditors rely on the knowledge of their IT department to gain access to the data in financial systems or ERP systems. When the IT department pushes back, the average auditor lacks the understanding to explain to the IT professional

how feasible and secure read access is to these source systems. The techniques are well-proven IT solutions.

Third, the audit profession accepts statistical and non-statistical sample testing as being sufficient for financial and compliance audits, so it's perceived as a given that auditors end up with detection risk because of sample testing. The profession simply concedes the existence of increased detection risk that in turn leads to increased audit risk. In fact, many audit professionals perceive 100% population testing with the support of CAAT as more than is required, even if the more advanced CAAT techniques can do full population testing faster and at a lower cost than manually performed sample testing.

XBRL for Compliance and Financial Audits

Extensible Markup Language (XML) is a markup language much like HTML. A big difference is that HTML was designed to display data, whereas XML was designed to transport and store data. Earlier we mentioned that a shortcoming of HTML was that standard CAAT solutions couldn't easily read HTML data to be used in audit procedures. XML, on the other hand, is commonly used in interchanging data, and any well-respected CAAT solution has adopted this widely used format.

XML allows the author of an XML file to define his or her own tags and document structure. XBRL is XML, but, instead of defining your own tags, XBRL has standardized identification tags for each individual item of data. The standardized XBRL tags make automated processing of financial data easier than using character-delimited ASCII files. For example, company net profit has its own standardized tag that won't change among XBRL files created by different users. Consequently, financial statements in XBRL format permit standardized automated analytical procedures to be used for different issuers who rely on the same standard XBRL tags.

Companies disclosing financial data that's unique for a specific industry use specific standard XBRL tags. Obviously, these tags aren't useful for other companies outside the specific industry. Consequently, automated analytical procedures that rely on these industry-specific tags can't be applied to companies outside the specific industry. For example, reinsurance recoverable might be disclosed on the balance sheet of an insurance company, but this specific line item wouldn't be found on the balance sheet of other types of companies. As a result, the level of standardization of XBRL allows for certain standardized automated analytical procedures for companies within

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the same industry.

Perhaps the use of financial statements in XBRL format is somewhat limited for auditors, considering that the financial statements are in an aggregated format. Auditors are still required to examine disaggregated financial data residing in the general ledger or subledgers in order to conduct substantive tests of transactions and tests of details of account balances to detect material misstatements. Misstatements in a financial statement are difficult to detect when analyzing data at aggregated levels. Testing the effective operation of internal controls based on digital data also requires disaggregated financial data. The same applies for conducting substantive procedures.

But standard XBRL tags are also defined for disaggregated financial data. These tags map to general ledger accounts. As a result, XBRL has the potential to standardize and automate many of the audit procedures for companies in the same industry that are currently conducted manually for each individual company. Since the computer executes an automated test procedure over the entire population as easily as over a random sample, these standard automated audit procedures drastically reduce detection risk and consequently, audit risk.

The Benefits

Auditors who have already worked with advanced CAAT using character-delimited ASCII files or XML have witnessed how easy it is to conduct audit test procedures over 100% populations rather than using conventional sampling techniques. As we mentioned, the benefits of testing 100% of the population are evident in the form of reduced detection risk, reduced audit risk, and, consequently, more-accurate assertions about general ledger accounts and factual conclusions about the effectiveness of internal controls over financial reporting.

Benefits also come from the continuous guaranteed level of quality. Performing a CAAT audit procedure leads to a consistent quality of working paper documentation because automated procedures eliminate the difference in work of different auditors. This is an important factor when external auditors decide to rely on the work per-

formed by internal auditors. Auditors use advanced CAAT to conduct audit procedures over multiple company facilities, regardless of geographical location. Since using this tool only requires access to a company's intranet, auditors can conduct audit procedures on multinational facilities from just one of the company's offices, such as headquarters. This means that staff time at the company's other facilities is no longer consumed by visiting auditors who need to learn about and check the accounting procedures at those facilities, and local staff no longer needs to prepare printed documents for visiting auditors.

All the benefits we've discussed so far were already available with the use of ASCII files or XML files, but XBRL offers some new ones, particularly the standardization of tag definitions by industry. Such level of standardization allows the same CAAT audit procedures to be conducted for different companies within the same industry. Auditors using CAAT currently have to customize audit procedures for a specific company since

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naming conventions and other metadata are often unique to one company's financial and ERP systems. There's no guarantee that a programmed audit procedure for company A can also be applied to company B since both companies often have unique configurations, even if they use financial and ERP systems from the same vendor. XBRL's level of standardization has the potential to change this.

For example, a public company with multiple facilities questioned the benefits of advanced CAAT for its compliance and financial audits. It argued that when it recently acquired several facilities, it acquired a variety of financial systems, each from a different vendor. The company's reasoning was that the differences in metadata per financial system would take away some of the cost-saving benefits of a computer-assisted audit because there would probably be customization per system for the same automated audit procedure. Using ASCII data, this issue could be solved by programming variables into the test procedures to manage the differences per system. With XBRL standardization, this wouldn't be necessary because the

same XBRL tag definitions would apply to data from all the different financial systems, regardless of vendor. This obviously simplifies writing automated audit procedures covering multiple financial systems.

A Good Opportunity

We hope we've conveyed how extensively XBRL creates new opportunities for the audit profession and for management accountants. Auditors can capitalize on an existing, widely supported technological development that can greatly improve the accuracy and efficiency of audit procedures. In addition to all the benefits of ASCII and XML data, XBRL offers additional benefits that potentially can affect a whole industry because of the extensive level of XBRL tag standardization. As with the other data formats, however, auditors have to gain new skills in order to be able to utilize XBRL in their audit procedures.

Management accountants can also play an important role in making sure that their company's financial or ERP system can provide accounting data in XBRL format as well as explaining how their system provides the required XBRL data.

It remains to be seen if auditors are willing to approach this technique proactively, even when it isn't mandated for the audit profession. The audit profession can seize this opportunity to minimize detection risk and audit risk, especially since these reductions will help minimize some of the concerns about auditors' negligence and add to the value of the audit opinion. **SF**

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