

2011

# lakkyara

Kyara, which means "precious" in ancient Japanese, is an aromatic resin regarded as the highest quality of all agarwood. "lakkyara [la-ká-la]" aims to deliver the same quality as Kyara together with NRI's endeavour for continuous excellence and innovation to provide the most advanced and up-to-date information to our readers worldwide.

**vol.97** (17.January.2011)

Improvement in XBRL financial reporting's accuracy is the key to dissemination of information in securities filings

XBRL holds promise as a means of rapidly disseminating large amounts of information contained in securities filings and analyzing increasingly diverse corporate operations from various angles. Initiatives to improve accuracy are needed for XBRL to effectively fulfill these functions.

### XBRL-compliant securities filings

The 2001 advent of EDINET<sup>1)</sup> has substantially expedited dissemination of information in listed companies' regulatory filings and increased the information's usership relative to when these reports were filed in hardcopy format. Once securities filings compiled in HTML<sup>2)</sup> have been uploaded to EDINET, they are available for anyone to peruse online. Since 2008, companies have been required to prepare the financial statement section of their securities filings in XBRL (eXtensible Business Reporting Language, an XML-based language used mainly to define financial information) to facilitate use of the data.

Before XBRL, financial information databases essential for valuing companies were compiled (e.g., by information service providers that sell subscriptions to the databases or financial institutions that use them internally) mainly by manually inputting data from securities filings. Securities filings typically comprise over 100 pages and are released by as many as 800 or more companies on a single day. The number of pages that could be input into databases was consequently limited by cost constraints. XBRL's advent promised to enable much more information to be rapidly disseminated to financial markets through automated data processing. In the two years since XBRL's adoption, some financial information services have indeed been rolling out updated databases earlier than in the past, but companies remain largely uninformed about how the XBRL data in their securities filings are used and very few users of the data come in direct contact with XBRL.

For investors to dynamically use XBRL content prepared by companies, several issues must be addressed, the two most important of which, both pertaining to accuracy, are discussed below.

### Issue (1): improving data accuracy

The first issue is numerical errors in XBRL content even when there are no problems with the financial statements' presentation on a computer screen or printed page. Such errors are presumably attributable to failure to adequately check the XBRL content. When XBRL content is printed on paper or displayed on a screen, it is formatted in a prescribed layout. Such formatting sometimes omits certain information, such as numbers' last three or six digits. Income statements printed on paper typically present individual line items in thousands or millions of yen. With XBRL, however, numbers must be input in units of one yen, but they are sometimes not input accurately. For example, XBRL data submitted by Company A were one one-thousandth of their previous year's values<sup>3)</sup>. When preparing its financial statements in XBRL format, Company A apparently mis-input the data in thousand-yen units<sup>4)</sup>. If these erroneous data had been automatically processed by a computer without the user noticing the error, the error could have led to misvaluation of the company.

Such errors can be prevented by carefully checking not only printed output but also XBRL content before submitting securities filings. Many users of XBRL data still have to check the data out of concern about inadequate checking or lack of understanding by the companies that prepare the data. Without assurance of data accuracy, the aforementioned benefits of XBRL's adoption are unlikely to be realized.

## Issue (2): increasing the precision of line-item definitions

The second issue is the risk that financial statements' line-item names fail to accurately convey their intended meaning. With corporate operations becoming increasingly diverse, the task of compiling financial data in comparable form has become more difficult, even if the data were correctly reported. When securities filings were published on paper, users comprehensively evaluated the information in the filings and classified it based on their interpretation of line-item names' meaning. To automate this evaluation step with computer systems, the requisite information must be accurately communicated in XBRL.

Examination of securities filings reveals that companies use the same or similar names for line items even if the line items have different roles, strictly speaking. To calculate growth rates or profit margins for the purpose of inter-company comparisons, users typically make assumptions regarding how Revenue (i.e., revenues derived from the company's main business activities) is designated on the income statement. Revenue is generally reported as Net-Sales in the manufacturing sector and Operating Revenues in the financial sector. However, with companies becoming increasingly diverse operationally even within the same sector, this general rule does not hold true universally. For example, Company B, a manufacturer, reports Net Sales, but because it is a holding company, it reports the sum of its Net Sales and other revenues as Operating Revenues. Although Company B is a manufacturer, it may be undervalued by the market if financial statement users assume that its Revenue consists of Net Sales alone. In its XBRL filings, Company B selected the standard EDINET tag<sup>5)</sup> "Net Sales" for its net sales on its income statement. If it had used a different tag to convey that its Revenue's composition differs from that of a typical manufacturer, its XBRL filings would have helped users to recognize this difference. XBRL tags are supposed to be selected based on their prescribed definitions. If two line items have different definitions, they should be tagged differently even if they share the same name.

XBRL tags indicate not only differences in line items' definitions but also the names of their parent line-items. Tags also have defined relationships in terms of how

line-item values are calculated (i.e., which accounts are included as line-item subtotals). XBRL can therefore precisely communicate accounting terminology's predefined meaning to users' IT systems. However, if companies select XBRL tags without carefully considering line items' definitions, the tagging will be meaningless and users will not benefit from XBRL's automatic identification capabilities. Wider dissemination of XBRL specifications and initiatives to adequately ensure compliance with tagging rules are prerequisites for all listed companies to prepare XBRL financial statements correctly.

## Initiatives to improve the quality of XBRL content

Because companies prepare their own XBRL financial statements, inconsistencies in the quality of XBRL financial reporting have come to be seen as a problem since XBRL was adopted by EDINET.

Efforts to ensure XBRL financial reporting's accuracy are already underway in the U.S. US auditing firms undertake agreed-upon procedure (AUP)<sup>6)</sup> engagements for objectively assessing XBRL-formatted financial statements. Some now deal with XBRL matters in these engagements. In the words of one US CPA<sup>7)</sup>, "One of the influencing factors as to the correctness, accuracy and completeness of company filings is the threat of litigation by investors. There is a 24 month window from companies' initial XBRL filing during which they have some degree of liability protection under the SEC mandate. After that 24 month period runs, subsequent XBRL submissions are then considered 'filings' and are subject to the same liability considerations as all other types of management reports to the SEC."

However, AUP reports are confidential communications between auditors and management. They are not available to public investors.

The American Institute of Certified Public Accountants (AICPA) has now started to discuss how to develop and provide guidance for assurance of XBRL formatted reports.

In Japan, the Financial Services Agency has embarked

on an initiative in 2009 to expand XBRL's scope and develop new functions, including more stringent checks. If investors and other financial statement users proactively express their views on matters such as improvement of data accuracy and expansion of XBRL financial reporting's content, XBRL should become easier to use. Any such improvement in XBRL's usability should ultimately benefit reporting companies also.

Only about 30% of Japan's approximately 3,800 publicly traded companies are currently covered by stock analysts. In recent years, Japanese have increased the scope of disclosures in their securities filings with respect to corporate governance, risk, and other such matters. Due to data-input cost constraints, however, not all of this information is currently being utilized as data. As companies diversify their operations, increasingly diverse criteria are needed to evaluate their long-term growth prospects. Promotion of XBRL's utilization can increase the probability of such diversification. The most essential requirement for XBRL's wider utilization is improvement in the quality of XBRL financial reporting. We hope to see further discussion of raising companies' consciousness, establishing an environment of checking, and building consensus on the need for assurance of accuracy.

### Note

- 1) EDINET (Electronic Disclosure for Investors' NETWORK) is an electronic disclosure system for securities filings and other disclosure documents in compliance with Japan's Financial Instruments and Exchange Act.
- 2) HTML (HyperText Markup Language) is a markup language for publishing web documents.
- 3) The examples of XBRL usage cited herein were excerpted from a presentation by Chie Mitsui (NRI) at the 21st XBRL International Conference.
- 4) With XBRL, financial statement numbers are input without rounding off any digits, but when financial statements are printed or displayed in printed page format, numbers can be preset to display in units of thousands or millions of yen. Consequently, if numbers are set to display in millions of yen, 500,000,000 would display as 500. If numbers are set to display in thousands of yen, 500,000 would display as 500. Such truncated numbers can easily be misread.
- 5) Tags are character strings used to mark up documents in HTML, XML, and other languages. XBRL, being an XML dialect, has tags for financial statement accounts. The tags convey the meaning of the line-items names.
- 6) With AUP, CPAs conduct procedures agreed to in advance with their clients and report on the results of the procedures.
- 7) Mr. Mike Willis, CPA (PricewaterhouseCoopers)



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