

## Preserving Wealth

### **XBRL: Financial Reporting Standardization**

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A company's financial statements, when prepared in accordance with Generally Accepted Accounting Principles (GAAP) or International Financial Reporting Standards (IFRS), can provide investors, creditors, and directors with a significant, clear understanding of the past, present, and future financial health of the business. Because financial statements are relied upon by so many stakeholders for decision-making purposes, decades of scholarly, commercial, and political activity has centered on improving the accuracy and timeliness of financial reporting. As financial reporting has taken on a larger role, so has the importance of the annual audit. As the Cadbury Report<sup>1</sup> aptly put it:

*The annual audit is one of the cornerstones of corporate governance. Given the separation of ownership from management, the directors are required to report on their stewardship by means of the annual report and financial statements sent to the shareholders. The audit provides an external and objective check on the way in which the financial statements have been prepared and presented, and it is an essential part of the checks and balances required. The question is not whether there should be an audit, but how to ensure its objectivity and effectiveness.*

Audits have indeed become increasingly objective and effective, especially since the enactment of Sarbanes-Oxley in 2002.

However, even properly audited financial statements, prepared in accordance with the very best and most recent standards of reporting, continue to be difficult and time-consuming to interpret and to understand. Well before Charles Hoffman proposed eXtensible Business Reporting Language (XBRL) in 1998, users of financial statements had been clamoring for a flexible, machine-readable solution. According to the American Institute of Certified Public Accountants (which has jointly developed the XBRL standard), the technology "provides major benefits in the preparation, analysis and communication of business information and offers cost savings, greater efficiency and improved reliability to those involved in supplying or using data."<sup>2</sup>

XBRL is simply an open standard for financial reporting, based on the more general eXtensible Markup Language (XML). It is a human and machine-readable text document that combines financial data with structured "tags," or metadata, which guide interpretation. In this manner, all user data is placed in a standardized, unambiguous context. An individual XBRL document is processed and understood by a computer through a taxonomy that helps the user or computer interpret the financial data. The taxonomy is an extensible but rigidly structured document that defines the allowable "tags," describes how the tags should be interpreted, and, importantly, can be modified independently of the XBRL document itself. The direct consequence of this separation is that financial statements can remain unchanged while different taxonomies can be applied for varying interpretations of the same information.

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This is especially useful when accounting standards, such as the IFRS, which change every year, are defined in taxonomy. Historical financial statements can be automatically “recast” or reinterpreted under changing accounting standards from year-to-year, allowing for a clearer understanding of financial trends.

XBRL is still in a development stage, but has already attracted the attention of the Securities and Exchange Commission (SEC), the CFA Institute, and the AICPA, as well as a large consortium of businesses aligned under the XBRL International organization. In 2005, the SEC began a voluntary program under which public companies were allowed to voluntarily submit XBRL-formatted files as exhibits to periodic reports.<sup>3</sup> Even as the attention to, and investment in, XBRL has increased, some concerns over the accuracy of public XBRL filings has emerged. In April 2009, a North Carolina State University study found multiple errors in signage, labeling, and classification from public filings in 2006.<sup>4</sup> The study noted that while both XBRL software and taxonomy has improved since 2006, registrants and accountants must receive further training in the complexities of XBRL to achieve successful adoption.

Why do we, as investment bankers, care about the adoption of XBRL? Why should you care?

XBRL has the potential to make interacting with your lenders, investors, and employees much simpler. It can also make sharing information easier. You’ll have fewer conversations about the minutia of your company’s accounting, spend less time spent generating financial reports, expend less effort justifying your company’s financial calculations, and your accounting and finance staff may virtually eliminate duplicate data entry. We hope, as one XBRL guide recently expressed, that “XBRL will become so seamless and so well integrated within the investment process that the very term ‘XBRL’ will become as invisible to investors as HTML is to the standard internet user today.”<sup>5</sup>

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<sup>1</sup> Report of the committee on the financial aspects of corporate governance. A Cadbury... - Gee, London, 1992

<sup>2</sup> “Charles Hoffman Receives AICPA Special Recognition Award for Contributions to the Development of XBRL.” AICPA. The American Institute of Certified Public Accountants, 11 Dec. 2006. Web. 2 Sept. 2009. <[http://www.aicpa.org/download/news/2006/Charles\\_Hoffman\\_Recives\\_AICPA\\_Special\\_Recognition\\_Award\\_12-11-06.pdf](http://www.aicpa.org/download/news/2006/Charles_Hoffman_Recives_AICPA_Special_Recognition_Award_12-11-06.pdf)>.

<sup>3</sup> <http://www.sec.gov/spotlight/xbrl/voluntary-disclosure.shtml>

<sup>4</sup> Bartley, Jon W., Chen, Y. Al and Taylor, Eileen Zalkin. A Comparison of XBRL Filings to Corporate 10-Ks - Evidence from the Voluntary Filing Program (April 30, 2009). Available at SSRN: <http://ssrn.com/abstract=1397658>

<sup>5</sup> CFA Institute Centre for Financial Market Integrity. eXtensible Business Reporting Language: A Guide for Investors. 2009. CFA Institute. Available at <http://www.cfapubs.org/doi/pdf/10.2469/ccb.v2009.n3.1>