Chapter 8
The Improvement of Governance Decision Making Using XBRL

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ABSTRACT

eXtensible Business Reporting Language (XBRL) has the potential to influence users' processing of financial information and their judgments and decisions. XBRL is an eXtensible Markup Language (XML)-based language, developed specifically for financial reporting. XBRL, as a search-facilitating technology, contributes to direct searches and simultaneous presentation of related financial statement, and facilitates processing footnote information which could help financial statements' users. XBRL is more than a distribution mechanism for data or facilitating technology. XBRL has the potential to significantly improve corporate governance. Putting that potential into practice requires an XBRL taxonomy model that is data based instead of document based. This paper hypothesizes that in the presence of search-facilitating technology, users' judgments of financial statement reliability will be influenced by the choice of recognition versus disclosure of stock option compensation than in the absence of search-facilitating technology. When the stock option accounting varies between two firms, the search technology helps in both acquiring and integrating relevant information. The paper suggests the implementation of XBRL improves transparency of financial information and managers' choices for reporting that information.

INTRODUCTION

XBRL is an issue that is directly related to one of IFAC’s key goals: enhancing the credibility of financial reporting and auditing across all sectors of the economy, public and private, for profit and not-for-profit, listed and unlisted. The importance of this issue is underscored by the accelerating demand for enhanced financial reporting through the use of technology. All the information users in the financial reporting supply chain are demanding more extensive financial and non-financial information. They need this information on a timely basis. It needs to be easily accessible and, where possible, tailored to specific needs. Listed companies are responding by exploring ways to provide...
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financial information faster, more accurately, and with greater confidence. Success, however, ultimately depends on two key factors: the quality and timeliness of the information produced, and the evolution of web-based technology tools that increase the flexibility and comparability of reported information, thus enhancing its value.

Additionally, the economics of XBRL are clear: XBRL provides a powerful return on investment, significantly lowering the cost of information production AND consumption. It is a flexible, scalable solution that facilitates exchange of data, streamlines communications, expedites information delivery and enhances transparency of reported information. It enables all those directly or indirectly involved in developing or using financial information to do so more cost-effectively.

XBRL is not a software application; also, it is not a new accounting standard. XBRL is a so-called semantic data format additional to an open and free electronic language providing each data element with a tag that identifies it unambiguously.

The data tags, prepared by XBRL format, provide information about the structure of financial data that allows software applications, such as search engines, parsers and so forth, to process the data more effectively. For example, software developed to search for these predefined data tags allows users to extract and simultaneously view all similarly coded information, notwithstanding where the information is presented in a firm’s financial statements. This search capability has the potential to contribute to increase the transparency of different accounting treatments, decrease users’ costs of processing information, and perform as a decision aid for users by facilitating the providing related information.

While search-facilitating technology has implications for numerous financial statement issues, recognition versus disclosure of financial information is likely one of the subjects which are most affected. In not too distant past, managers have strongly opposed standard setters’ proposals to recognize in the financial statements items such as stock-based compensation and unrealized gains/losses on financial assets, preferring instead that these items be disclosed in the footnotes. One possible explanation for this vigorous opposition to recognition is that there exist economic costs accompanied by recognition if debt covenants or other contracts are restricted by recognized, but not disclosed, amounts. A second explanation is that managers believe that the items in question do not meet the Financial Accounting Standard Board (FASB)’s relevance and reliability criteria for recognition, and thereby deem disclosure the appropriate reporting alternative. A third explanation is that managers believe that users fixate on recognized items and discount disclosed items in view of processing costs or cognitive limitations. Such a belief would lead managers to disclose information they believe would harm firm value if recognized in the body of the financial statements.

**RECOGNITION VERSUS DISCLOSURE**

The FASB’s conceptual framework states that an item should be recognized in the body of the financial statements only if it (1) meets the definition of a financial element (e.g., asset, revenue); (2) is measurable with sufficient reliability; (3) is relevant to users’ decisions; and (4) is reliable in the sense of being representational faithful, verifiable, and neutral (SFAC No. 5, para. 63). Items that fail to meet one or more of these criteria are candidates for disclosure.

According to Johnson and Storey (1982), items primarily fail recognition tests due to uncertainty about the item’s existence or its monetary value. Financial accounting standards rarely allow recognition and disclosure as acceptable alternatives for presenting financial statement information; one exception is stock option compensation. In the early 1990s, corporate managers and standard setters engaged in vigorous debate over the placement of stock-based compensation within a firm’s
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