

STANDARDIZING THE PRESENTATION OF FINANCIAL DATA: DOES XBRL'S
TAXONOMY AFFECT THE INVESTMENT PERFORMANCE OF
NONPROFESSIONAL INVESTORS?

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Cassy D. Henderson

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PREVIEW

Dedication

To my husband, Frank Henderson, and my two children, Avery K. Henderson and Jack Henderson. Without your love and support, I would have never been able to complete this.

PREVIEW

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PREVIEW

Abstract

Extensible Business Reporting Language (XBRL) is mandated in the United States with the intention of making financial information more useful and easier to analyze. XBRL technology defines financial information, and when implemented as intended, has the ability to standardize the items presented in the financial statements. Standardizing financial information is likely to benefit investors by simplifying the acquisition and integration of the information. Nonprofessional investors have limited knowledge and experience analyzing financial statements and are likely to benefit from a standardized presentation format. Using 167 graduate business students as proxies for nonprofessional investors, the current study examines how standardizing the presentation of financial data impacts investment performance by investigating the number of financial ratios correctly calculated, task completion time, investment decision, and confidence in decision-making. Because XBRL technology produces financial statements that are likely viewed in an online format, the study also investigates how presentation view affects investing performance. I conduct a 2 X 2 full factorial between-participants design manipulating presentation format with two factors: format and view. Each factor is manipulated with two conditions. Format condition includes a standardized presentation and a non-standardized presentation of financial information, and the view condition includes a paper and an online presentation of the information. Results show standardizing financial information improves one's ability to correctly calculate financial ratios, reduces the time taken to complete the task, and increases confidence in decision-making. The results offer evidence on the value of standardizing the presentation of financial statements and the benefits XBRL technology provides investors.

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Chapter 1: Introduction

1.1 Background

Financial statements represent the financial situation of a company and are intended to provide relevant information for decision making. Companies are required to follow certain guidelines and formats when creating their financial statements. The Financial Accounting Standards Board (FASB) provides principles for accountants to follow when creating financial statements to ensure the information will be useful for decision-making. Some of those guidelines are: relevance and reliability, materiality, matching, prudence, and comparability principles. While all principles are equally vital, this study focuses on comparability because decision makers must be able to compare the historical and the current performance of a company, as well as be able to evaluate performance between companies and between industries. Without a common method of presenting financial information, comparability is lost. The United States' (US) most recent attempt in increasing comparability of financial information is shown by the current mandate of XBRL technology. As of June 2011, public companies and foreign private issuers are required to prepare and submit their financial statements in XBRL format in addition to the regular text format.

1.2 XBRL

Extensible Business Reporting Language (XBRL) technology was created to improve the efficiency, reliability, and comparability of financial data (XBRL International, 2012). Benefits include the ability to extract information from a broad set of companies for analysis and comparison without having to refer to the printed financial reports (Plumlee & Plumlee, 2008). The technology is intended to facilitate the acquisition of information, making financial analysis easier, more efficient, more accurate, and to reduce the cost of preparing, reporting, and

analyzing financial information (Securities and Exchange Commission, 2009). The technology has the capability to retrieve information requested by users regardless of its placement in the financial statements. For example, a request for all items relating to “employee compensation” would retrieve all information that is related to salary or other employee benefits, whether it is listed on the face of the financial statements or in the notes (i.e. stock-option compensation) (Hodge et al., 2004).

These capabilities are derived from the use of an official taxonomy, which allows for the identification or tagging of each individual item in the financial statements to a predefined list of standard elements and corresponding account labels. Tagging financial items with standard elements acts similar to barcoding by applying a unique and identifiable tag for each financial concept, allowing users to identify the concept regardless of the account description or label used by the firm. When an appropriate tag does not exist, customized tags may be created. Customized tags that extend the official taxonomy and/or alter the labels associated with official tags are known as taxonomy extensions. Taxonomy extensions are receiving attention in the literature because their use is found to be unnecessary and excessive (Boritz & No, 2009; Zhu & Fu, 2009). Unnecessary or the excessive application of taxonomy extensions is likely to affect the judgments and decisions of users by reducing comparability and impeding the acquisition of information.

1.3 Using XBRL

The technology is intended to provide benefits to both professional and nonprofessional investors. XBRL can facilitate the process of analyzing financial statements for professionals, allowing them to analyze more companies, particularly those companies that have in the past been considered too small or not cost effective to include in their analysis. Nonprofessional

investors, those with limited investment experience and skillsets, benefit from the technology's ability to provide information that may not have been acquired and integrated when searching traditional financial statements (Hodge et al., 2004). Hodge et al. (2004) find participants using search-facilitating technology are better able to acquire and integrate information only found in the footnotes, compared to participants not using the technology. Thus, search-facilitating technology, such as XBRL, improves the acquisition and integration of financial information for nonprofessional investors. However, for the technology to be effective, users must possess and use specialized software to search for and acquire the desired financial elements. Currently, XBRL software with full functionality to produce, read and search XBRL documents is not available in an off-the-self software package, making it expensive and likely to be used only by professional analysts or large companies. At present, nonprofessional users are able to read XBRL-formatted financial statements using the viewer provided on the SEC's website, but the SEC's viewer does not allow users to search for and acquire specific items; it simply allows them to view the rendered XBRL-formatted information. Thus, it appears that, at XBRL's current stage of diffusion in the US, the technology may not be as helpful for all investors as initially intended. The current study, however, explores whether XBRL can be useful to investors in an unintended way.

Although the intended capability for searching and acquiring of financial information is not easily accessible for all investors, XBRL may be helpful because of its ability to standardize the information displayed and is derived from the technology's official taxonomy. Standardizing the presentation of financial information refers to presenting the same financial concepts in the same manner. Standardizing financial information may be helpful because investors encounter a variety of unique account labels and methods of providing financial information when analyzing

the financial statements of companies. Very simply, companies refer to income earned as Sales, while others refer to it as Revenues. In other cases, such as disclosing stock-based compensation, information required to be presented on the face of the financial statements, companies have various ways of providing this information. Some companies choose to combine compensation amounts with other expenses, while others deliver the information in a separate section on the face of the income statement. A good example of this is illustrated in the financial statements of Google Inc. and Yahoo Inc. Both companies belong to the internet information providers industry but disclose stock-based compensation on the face of the income statement differently. Google Inc. allocates a portion of stock-based compensation to their operating expenses and presents the information in the following manner: “Selling and marketing expenses (including stock-based compensation of \$100)”. When investors are viewing Google’s expenses they should interpret this information as \$100 (in millions) of its total selling and marketing expenses is stock-based compensation. Yahoo Inc. also allocates stock-based compensation to operating expenses, but displays the information in a separate section at the bottom of the income statement. Yahoo Inc.’s presentation is comparable to displaying the information in the notes section of the financial statements in that it requires the investor to actively search for this information. XBRL technology can standardize the presentation of financial information because the technology defines and presents it using an official predefined element with its corresponding label. For example, the terms “Accounts receivable”, “Trade receivables”, or “Receivables” commonly used to identify the money due from customers for products sold or for services rendered, would be identified by XBRL software using the official taxonomy element, “accountsreceivablenet”, and corresponding label, “Accounts Receivable, Net”. In summary,

XBRL technology reports the same financial concepts found in most financial statements to be presented in a constant manner.

Researchers have found that some investors, particularly nonprofessional investors, can be affected by the manner in which financial information is presented (Maines & McDaniel, 2000; Koonce et al., 2005). This is supported by the theory of cognitive fit which states that performance is negatively affected when a match does not exist between the information presented, the skill, knowledge, the experience of the individual, and the task. Because nonprofessional investors possess a limited amount of experience and familiarity with financial statements, they are likely to be affected by differences in the way financial information is presented. Identifying financial information using only elements from the official XBRL taxonomy would present similar information in the same manner (standardized it) which may improve the investment performance of nonprofessional investors; unique, customized names for the same financial concepts would no longer exist. Identifying and presenting information in a standardized manner would increase the comparability between companies and industries and would likely make the acquisition and integration of the information less complicated for investors, specifically for nonprofessional investors. I posit that XBRL technology's ability to standardize the information presented, through the use of its standard taxonomy, benefits investors by improving their investment performance.

Researchers have also found individuals perform at lower levels when information is presented online rather than on paper, indicating that online displays may hinder performance (Dillon, 1992; Galletta et al., 1996). XBRL is a computer reporting language and users are expected to view information online. Further, at XBRL's current stage of diffusion, most investors will only be able to view these documents online using SEC's XBRL viewer. While the

main focus of the study is investigating the influence of standardizing the format of financial information, because XBRL documents are more likely to be viewed online and because researchers find this hinders performance, this study also examines the effects on performance when information is viewed on paper and online. This manipulation is included to rule out the possibility that performance is influenced by the view provided.

Using the theory of cognitive fit as my theoretical background, I conduct a 2 X 2 full factorial between-participants experiment to examine how the standardization (or lack of standardization) and delivery method (paper-based or online display) affects the investment performance of nonprofessional users. Cognitive fit occurs when the decision processes required by the task match the decision processes supported by the problem representation (Vessey, 1991; Vessey & Galletta, 1991). This match allows individuals to have a consistent and accurate mental representation of the problem; which in turn, leads to more effective and efficient task performance. On the other hand, when the problem representation does not match the task, cognitive fit will not occur because similar decision processes cannot be used on both the problem representation and the task. As a result, the problem solver must exert additional cognitive effort to either transform the problem representation to better match the task or transform their decision processes to better match the problem representation. This increase in effort, due to a lack of cognitive fit, results in individuals increasing task time and/or decreased accuracy (Vessey, 1991; Vessey & Galletta, 1991). Performance of nonprofessional investors when the format of financial information is manipulated as standardized or non-standardized and the view of the information is manipulated as paper or online displays is measured by the number of ratios correctly calculated, the amount invested in the company considered to be the more

profitable, the time required to complete the analysis, and the confidence in the correctness of ratio calculations.

The results indicate standardizing financial information improves performance. As predicted by cognitive fit theory, it appears that participants analyzing standardized financial statements were better able to acquire and integrate information than those receiving non-standardized information. Specifically, the number of correct ratio calculations was greater and the time taken to complete the analysis was shorter when the information presented was standardized. No effect was found for perceived confidence or in the amount invested in each company. Although participants viewing non-standardized information correctly calculated fewer ratios than those viewing standardized information, they were still able to select the more profitable company to invest in. Participants were also slightly affected by the view of the information presented with the results showing participants viewing the information on paper spent significantly less time to complete the analysis than those viewing the information online. In summary, the results suggest that standardizing the presentation of financial data is likely to ease the task of acquiring and integrating financial data for nonprofessional investors by reducing the mental processes required for judgments and decision making.

The remainder of this dissertation is organized as follows. Section II provides background information on XBRL technology and discusses different types of users of financial data. Section III discusses the theoretical framework used to support the hypotheses. Section IV discusses the research method used. Section V presents the results of the study. Section VI includes the discussion, conclusion, limitations, and suggestions for future research.

Chapter 2: Background of XBRL

2.1 Overview of XBRL

In June 2009, the Securities and Exchange Commission (SEC) began requiring all publicly held companies to file and to publish on their corporate website their financial statements in Extensible Business Reporting Language (XBRL) format. The Commission's intention behind the mandate was to provide users of financial information an easier, more efficient, accurate, and reliable manner of obtaining and analyzing data from an organization's financial statements (Securities and Exchange Commission, 2009). These proposed benefits are derived from the technology's ability to identify and give meaning to each item within the financial statements and is facilitated by a standardized taxonomy that defines the data in the financial statements and transforms the information into computer-readable and human-readable formats. There are several markup languages, such as HyperText Markup Language (HTML) and eXtensible Markup Language (XML), which allow information to be interpreted by computers and read by humans. HTML is primarily a presentation language, allowing information to be viewed on internet browsers. XML is similar to HTML in that it also allows information to be viewed in browsers; however, XML is more powerful in that it allows the transfer of data between databases and applications. The difference between these two computer languages can be summarized as: HTML is primarily used to *display* data, while XML's main function is to *describe* the data. XBRL technology is the business reporting language for XML documents. It allows information to be viewed in internet browsers and describes data; however, it specifically describes and displays financial data. The technology's ability to describe and display financial data provides various benefits for users.

XBRL technology was developed as a means to transform business reporting by automating data collection and standardizing the presentation of financial data, thereby increasing the efficiency, accuracy, and reliability of preparing and analyzing financial information (XBRL International, 2012). One benefit for investors is the ability to access financial information faster. Also, the decision-making process should be more efficient using XBRL technology because the software can search for and retrieve specific information, eliminating manual searches. Investors are also able to analyze the information from a broad set of companies without having to print and work through multiple financial reports (Plumlee & Plumlee, 2008). Lastly, using predefined taxonomies standardizes the presentation of financial data, which is likely to reduce investors' time to decipher differences between one company's methods of disclosing its financial data from another company's.

XBRL taxonomies are hierarchical dictionaries that contain hundreds of predefined elements, their attributes, and their interrelationships that are needed to identify financial information (XBRL International, 2012). When XBRL-formatted financial statements are created, financial information is "tagged" or identified by these elements. Tagging financial information with the appropriate predefined elements standardizes financial statements. Standardizing financial reporting is one of the key reasons behind the SEC's mandate (Securities and Exchange Commission, 2009). However, when information is not tagged to an element listed in the taxonomy or when additional elements (i.e. taxonomy extensions) are created, standardization of financial reporting is diminished. The inclusion of taxonomy extensions is sometime necessary, as an appropriate element may not exist in the taxonomy, but researchers have found extensions are often misused and overused (Boritz & No, 2009; Zhu & Fu, 2009).

2.2 Research on Taxonomy Extensions

Creating taxonomy extensions is necessary when an appropriate element cannot be matched to a financial statement item. Although extending the taxonomy may be necessary, it contradicts the purpose of XBRL technology because it diminishes the standardization of financial data and reduces comparability between companies and industries. Extant research finds evidence of diminished standardization and comparability when firms misuse and overuse taxonomy extensions (Boritz & No, 2008; Boritz & No, 2009; Debreceeny et al., 2010; Zhu & Fu, 2009). Boritz and No (2008) find voluntary SEC submissions were vastly comprised of taxonomy extensions and contained errors that resulted in substantial differences between the XBRL filings and the traditional filed financial statements. Most companies' use of taxonomy extensions was in excess of fifty percent of the total tags applied, illustrating the overuse of taxonomy extensions. Unnecessary and redundant use of elements and extensions carried forward after the voluntary period of XBRL filing ended (Boritz & No, 2009). Similarly, in a study of 140 XBRL instance documents listed on the SEC's website, Zhu and Fu (2009) discovered that companies used 128 of the defined elements and created an average of 64 of their own. Table 2.1 presents a sample of some of the unnecessary extensions created and shows the similarity between elements. The extensions are considered unnecessary because they provide no additional relevant information. This is particularly apparent in the "*NetIncomeRetainedEarnings*" element—it can be linked to either net income or retained earnings, but not both, as the extended element implies.

Table 2.1: Sample of Unnecessary Taxonomy Extensions and Possible Matches

| <u>Extended Element</u> | <u>Possible Match to the Official Element</u> |
|----------------------------------|---|
| CashCashEquivalentsBeginningYear | CashCashEquivalents |
| OperatingActivitiesNetIncome | NetIncome |
| PurchasePropertyPlantEquipment | PropertyPlantAndEquipmentNet |
| NetIncomeRetainedEarnings | NetIncome or RetainedEarnings |

The SEC’s staff in the Office of Interactive Disclosure (OID) conducted annual analyses of XBRL filings beginning with the voluntary filing group in 2009 and extending to the first two months of 2011. Their analysis of XBRL furnishings provided by the initial voluntary filing group reveal several discrepancies between the rendered XBRL financial statements and the official HTML/ASCII financial statements (Securities and Exchange Commission, 2009). The staff finds many discrepancies in the statements such as inconsistencies between the paper and XBRL versions of the financial statements, use of broad elements when a more defined element exists, and the creation of new extensions when appropriate standard elements already exist in the official taxonomies (Securities and Exchange Commission, 2009). The SEC’s OID staff has stated that the misuse and overuse of taxonomy extensions will lead to “lower data quality of the submission” and likely will have some impact on users, although those statements have not been supported by research thus far (Securities and Exchange Commission, 2011). The creation of XBRL and its subsequent mandate by the SEC was designed and implemented to benefit users; however, there is no research that examines these possible benefits. The current study seeks to fill this gap by comparing the effect that standardized and non-standardized financial information has on investment decisions.