

TESTIMONY OF

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BEFORE THE

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ENTERPRISES SUBCOMMITTEE

OF THE

HOUSE COMMITTEE ON FINANCIAL SERVICES

CONCERNING

FOSTERING ACCURACY AND TRANSPARENCY IN FINANCIAL

REPORTING

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My name is Barry Melancon. I am the President and CEO of the American Institute of Certified Public Accountants. On behalf of the AICPA, which has been representing the accounting profession for almost 120 years, I truly appreciate the opportunity to present testimony to this Subcommittee about increased accuracy, accessibility, and transparency in corporate financial and other business information, including non-financial information that is useful to investors making decisions.

I am here today representing the approximately 330,000 Certified Public Accountants who are members of the AICPA. Approximately 142,000 of our members practice in business and industry in both public and private companies as CFOs, controllers, and internal auditors and accountants. These professionals are integral to companies producing the financial statements and quarterly and annual reports that are currently used by shareholders, lenders, regulators, and others who make investments in, do business with, and provide oversight of corporate America.

An additional 139,000 AICPA members are in public practice. The work that many of them perform, auditing public and private companies, make it possible for investors and other users to have reasonable assurance that the financial information published by management is credible and reliable. That helps to create the confidence capital markets need to make the investment decisions that fuel economic growth.

AICPA is hardly a newcomer to the discussion on business and financial reporting this Subcommittee is having today. To the contrary, in one way or another, AICPA and its members have been at the center of this topic since the need for useful and accessible financial and business information was first understood to be vital.

The existing financial reporting model provides a solid foundation, but the profile of today's companies has changed. The nature of their assets, how they are managed, and the performance indicators that senior executives routinely use underscore the need for a model that focuses not only on financial information, but also on a range of contextual and non-financial information that provides an enriched understanding of company performance, values, strategies and potential. As an example, in the industrial era, the physical assets of the manufacturing company were of significant importance to the users of a company's financial information. Today this continues to be true, but intellectual assets, which are not captured by financial statements and traditional business reporting, can be much more important. For example, an industrial company, while needing intellectual assets to create its products, has an equal need for the tangible assets of its manufacturing plant to be successful. However, the tangible assets of a software company are much less important to its success than the education and caliber of its workforce. Virtually all that the software company needs to be successful is a good intellectual property. We need to find a way to disclose and to communicate these types of corporate assets to users.

In some cases our involvement has been public and formal—like this hearing and the Senate Banking Committee testimony the AICPA presented in July 2000 on financial reporting methods for the 21<sup>st</sup> century.

In other instances, AICPA and its members have formally researched, discussed, and debated this subject internally.

All of this is part of our jobs and mission as individuals, professionals, and a profession.

Five recent examples of our activities demonstrate how the topic of useful and accessible financial and non-financial business information has been a preoccupation for AICPA and its members.

In 1993, the AICPA Special Committee on Financial Reporting, which is better known as the Jenkins Committee because of its chairman, Edmund L. Jenkins, the former Chairman of FASB, published a report called "Improving Business Reporting - A Customer Focus. Meeting the Information Needs of Investors and Creditors." Although the word wasn't in vogue at the time, that report was one of the first to call for what today we would describe as a broader "bandwidth" of information from public companies. This report was issued with the recommendation of providing greater and more useful information to investors.

Three years later, the AICPA Special Committee on Assurance Services published a report building on the work of the Jenkins Committee.

In 2000, the AICPA Accounting Standards Task Force of the Group of 100 developed an internal report called "Achieving a New Business Reporting Model for the 21st Century," which focused on motivating investors to demand a better reporting model and capital users and regulators to supply it.

Fourth, the AICPA Special Committee on Enhanced Business Reporting, which was active from January 2003 through January 2005, established the *Enhanced Business Reporting Consortium*. The Consortium is on the cutting edge of developing a voluntary framework for the disclosure and presentation of relevant value drivers, financial and non-financial performance measures, and qualitative information around strategy, plans, opportunities, and risks. For example, the framework will

provide best practices guidance for the disclosure of indicators of customer satisfaction and workforce demographics. These are areas that have significant relevance to the financial success of a business and that we all want to know, but that companies generally don't disclose on a regular basis to investors. The consortium is also promoting easing complexity in existing financial reporting requirements and is conducting research to identify the relative usefulness of disclosures to key user groups with the intention of issuing recommendations for simplification.

Fifth, in a similar fashion, the AICPA chartered XBRL International in 2000 to foster the global growth and adoption of "XBRL" – eXtensible Business Reporting Language—that AICPA started in 1998. XBRL is a language for the electronic communication of business and financial data which is revolutionizing business reporting around the world. It provides major benefits in the preparation, analysis and communication of business information. It offers cost savings, greater efficiency and improved accuracy and reliability to all those involved in supplying or using data. XBRL is what makes it possible to use the EBR framework effectively.

The United States has the most efficient capital markets in the world. But, twelve years after it was discussed in depth by the Jenkins Committee, we know that business and technology have progressed and it is time for improved financial and non-financial reporting models that meet the needs of today's markets. Investors require it, the technology exists to provide it, and capital markets will function even more efficiently with it.

The only excuse for not implementing an enhanced business reporting model—inertia—is unacceptable.

Every business student will tell you that information is the key to a free and successful economy. Indeed, the success of U.S. capital markets has always been based on what we today call "transparency," that is, available, highly credible, informative, and reliable financial and non-financial business reporting.

This was true long before the corporate scandals of the recent past once again made it obvious. As the U.S. economy has changed from one that is overwhelmingly based on physical assets to one that is increasingly dependent on intangibles, it has become clear to us, FASB, and the SEC that existing accounting models are not as well-suited to the task of informing investors as they need to be.

In addition, investors and other users of the information want that information provided on a timelier basis than it is today. Quarterly and annual reports, which are useful, primarily provide historical rather than current information. Because of that, they are not as helpful to investors and lenders who need to make decisions much faster than they did in the past

Currently, there is a limited amount of truly up-to-date information that investors use to assess corporate earning capacity. Useful and timely information has always been highly valued but, because of the growth of online reporting and electronic news sources such as Bloomberg and CNBC, the speed of activity and the rapid reporting of external events important to companies and sectors are more important today to users of the information than ever before. Indeed, the risks facing today's corporations are greater if for no other reason than investors react to them faster. That means that investors need or, rather, demand more and better information and they want it delivered far more quickly than has ever been the case.

Coupled with enabling technologies like XBRL, Enhanced Business Reporting will provide users the breadth of information they require at the speed they need to be successful in today's economy. AICPA believes EBR, enabled through XBRL, will make this happen. The technology has been created to allow users of information to access that information on close to a real time basis rather than waiting for a quarterly or annual report and the currently commonplace conference call with the management team. Coupled with the Internet, which allows key financial and non-financial business information to be widely available electronically, XBRL will enable this information to be utilized more effectively. All of this will make capital markets far more efficient.

Most important, EBR will also allow a far richer mix of information to be available to consumers of business information. One of the consistent findings of the groups and task forces that have worked on this issue for the AICPA is that enhanced financial reporting is now necessary.

The EBR Consortium is concentrating on the development of an internationally recognized framework that will establish voluntary guidelines for reporting key business information that falls outside of traditional financial statements. This will allow for more complete, relevant, consistent, and useful disclosures by putting structure around the reporting of this information for companies seeking best practice guidelines. The EBR framework organizes this kind of information into the following four categories:

- Business Landscape: The company's perspective on the business and economic climate as well as other external forces that could affect the entity's business strategy and its ability to achieve success.
- Strategy: This section builds on Business Landscape and communicates not only the business strategy, but also how the organization and the underlying structures support the execution of strategy.
- Competencies and Resources: A description of how the company manages available resources and competencies to execute the company's Strategy. A principal goal of this section is identification and discussion about value drivers-the elements of a company's business that are the sources of its value.
- Performance: This section provides insight into whether the company and its management team have produced results in line with stakeholder expectations. It is critical to explain relationships linking the Business landscape, Strategy and Competencies and Resources. Ultimately, the key performance indicators or narrative about qualitative factors presented in this section will enable stakeholders to better assess sustainable business practices and the quality and variability of a company's cash flows and profitability.

The framework will be customized on an industry by industry basis through a collaborative process involving corporations, investors and other key participants in the corporate reporting supply chain. A series of sample reports illustrating how a company might apply the framework is available at

<http://www.ebr360.org/ContentPage.aspx?ContentPageId=8>.

Investors want more transparency today in the American capital markets, and the EBR framework will play a key role in achieving transparency by enabling

stakeholders to see the potential of a company through the eyes of management. The overarching objective of the EBR Consortium, however, is to achieve the right mix of fully disclosed, high-quality information, made possible not only by adding critical information that is not currently disclosed (the role of the EBR framework), but also by advocating for improvement in the consistency and relevance of existing disclosures. We believe that transparency can be further enhanced through a stronger focus on the quality, not quantity, of reported information, and that there are opportunities for simplification of reporting requirements. Decades of ever-increasing and more complex disclosure requirements have in some cases resulted in disclosures that have marginal usefulness because they are no longer relevant, redundant, or overly complex and hard to understand. The Consortium has established a Reporting Simplification Task Force to conduct research aimed at garnering a better understanding of the relative importance of financial and non-financial disclosures currently provided in an annual report to a wide variety of users. The task force intends to make thoughtful recommendations for the simplification of existing disclosure requirements based on the findings.

EBR and traditional financial reporting delivered electronically, available on demand, and tagged by XBRL technology, when adopted will enable users to answer questions about a company's financial condition at no marginal cost to the company. Users will have current data that, using XBRL, they will be able to mine more efficiently. Users will be able to customize the data they need to conduct the analysis they feel is important in ways that they cannot do today. And with a speed and efficiency that is not available today. Equally as important, the information will be in a format that facilitates analysis and comparison.

In much the same way that pocket calculators and personal computers made it possible for auditors and accountants to do things faster and more efficiently, XBRL and the internet will enable corporate reporting to move seamlessly and painlessly to a level of content that has long been contemplated but never before delivered. Indeed, up to now it has not been deliverable.

XBRL is a true American success story. It was conceived by Charlie Hoffman, a CPA who worked for a small firm in Washington State. He brought it to the AICPA, which has worked hard and invested a great deal to make it a reality.

XBRL is now a global effort that has been adopted as far away as China as well as here in the United States with the recent success of the FDIC Call Report Modernization project based on XBRL and the SEC voluntary filing program.

XBRL is the business reporting equivalent of bar coding. Because of greatly enhanced information and reduced errors, the now ubiquitous codes of thick and thin lines we all see in stores have made product distribution far more efficient and much less costly. Bar coding has saved the grocery industry \$17 billion per year because inventory management, pricing, and consumer sentiment are now measured and queried at a far lower cost. It has also increased the grocery industry's capacity to carry substantially more items in its inventory. The AICPA expects the same type of results with XBRL. Attached to my testimony as Exhibit 1 is additional detailed information on what XBRL is and how it functions.

XBRL will do the same for business and financial reporting by making it easier for investors and analysts to find the reported details they are seeking about a company's operations and results and make better use of this information. That is

why it is no wonder that Securities and Exchange Commission Chairman Cox is one of XBRL's biggest supporters. Just last week he told CNBC that XBRL's interactive features and depth of information will make it possible for investors to get the information they need quickly, effortlessly, and at little cost. He also praised United Technologies for voluntarily filing its financial information in XBRL format this year. The AICPA is grateful for Chairman Cox's support and is eager to work with the SEC to make XBRL available and as ubiquitous as those barcodes.

XBRL is only one of several elements that will have to be considered as the evolution towards a reporting model that meets the needs of today's markets continues to become a reality. Others include:

- Engaging markets in the development of a structured framework for enhanced business reporting information on an industry-by-industry basis so that EBR can be used to its full potential.
- Simplifying overly complex reporting. The AICPA actively participates in the Enhanced Business Reporting Consortium Reporting Simplification Task Force, which is currently working to identify the relative usefulness of disclosures to key user groups with the intention of issuing thoughtful recommendations for simplification
- The increasing need for international convergence of reporting and auditing standards

- The need for auditors to provide timely assurance on the information systems used and underlying data elements rather than just summary level assurance on the basic financial statements
- The need for improved safe harbor legislation to protect directors and managers who produce the financial and business reports and the auditors who audit the financial statements where a good faith effort to provide more high-quality and transparent disclosures has been made

Finally, in addition to what has been discussed concerning Enhanced Business Reporting, XBRL and the usefulness of financial and non-financial business information with regard to public companies, it is important that a little more be said about these activities in the private company sector. 99.7 percent of incorporated businesses in the United States are private companies and their impact on the U.S. economy is significant. Because we believe that the needs of users of private company financial statements differ in some ways from the needs of investors and other users of public company financial statements, the AICPA Board, in late 2003, established the Private Company Financial Reporting Task Force whose primary charge was to determine whether or not financial statements of private, for-profit entities, prepared in accordance with generally accepted accounting principles (GAAP), were meeting the needs of those private companies. Partly as a result of that effort, the AICPA is currently conducting an historic effort with FASB that is focused on meeting the financial reporting needs of private company lenders and investors.

All of these issues are important and deserve concerted and thoughtful dialogue. They do not, however, mean that doubts about the value of Enhanced Business

Reporting should exist at this point. To the contrary, EBR is essential to the future of the U.S. economy, the proper functioning of capital markets, and investor confidence. Its promise is extraordinary.

The AICPA wants the promise of EBR and XBRL to be realized as quickly as possible. We are looking forward to working with this Subcommittee, the SEC, corporate America, and public accountants to make this happen.

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## Transforming Business Reporting

XBRL (eXtensible Business Reporting Language) is a royalty-free, open standard for the tagging of information to improve the quality and transparency of business reporting. XBRL permits the automatic exchange and reliable extraction of business information across all software. XBRL is not a proprietary software product, but an open standard developed by XBRL International Inc., a not-for-profit consortium of over 400 companies and agencies. XBRL is designed to:

- Enhance the usability of business data by eliminating the need to re-key, thereby minimizing the risk of error.
- Make each financial item identifiable to software that understands XML and that conforms to the XBRL 2.1 specification by using a tagging scheme.
- Report all the pertinent context of the data, e.g., whether it is segment data, part of an audited statement, etc.

Taxonomies are dictionaries of business terms and their corresponding tags, e.g., US GAAP taxonomy. Instance refers to an XBRL-enabled document.

### Today's Problems: Without XBRL

- It is time-consuming for users to extract business information and organize it for analysis.
- Investors and analysts benchmarking company performance against other companies do so with considerable guesswork, manual intervention and re-keying of data.
- Reporting is based on a rigid reporting calendar rather than event or risk-driven.
- Format limitations cause presenters to reduce the extent of the information that could be delivered.
- Preparers have limited methods to organize information to highlight salient facts.

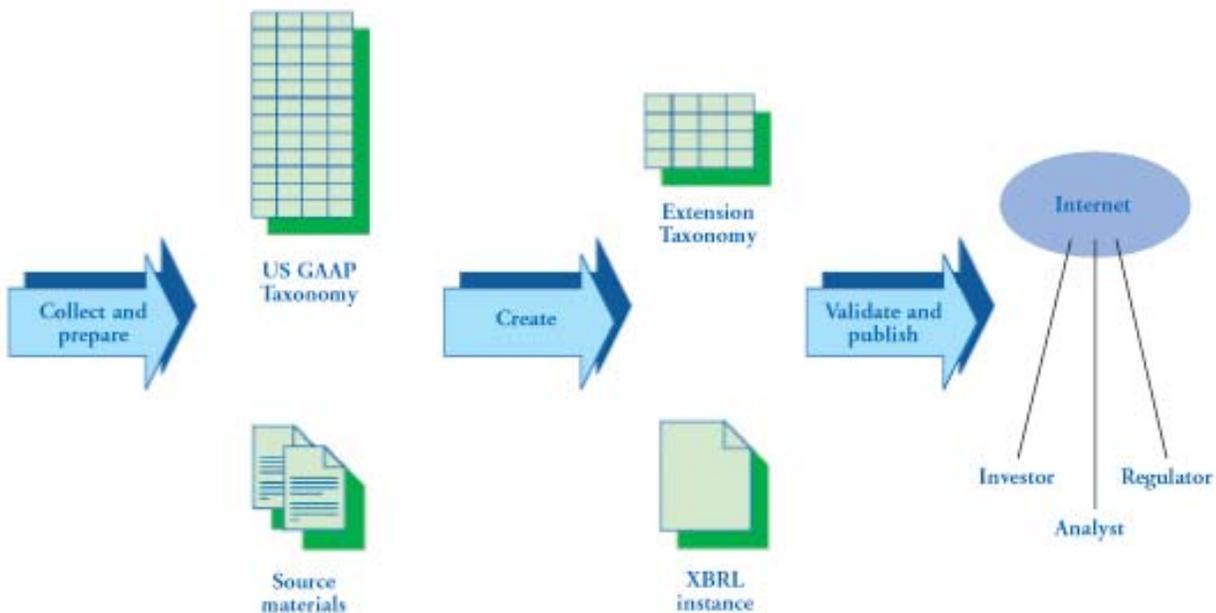
### Tomorrow's Benefits: With XBRL

For public companies:

- Reduces workload – publish a single set of tagged results simultaneously through a multitude of channels including interactive Web sites.
- Communicates pertinent information and analysis to investors, analysts and other stakeholders without relying on third parties to interpret and repackage the information.
- Demonstrates tangible commitment to greater transparency for early adopters.
- Improves access to information as users drill down to the data needed, using their own analysis tools (preparer of the results controls the depth of potential drill-down).
- Data can be compared and benchmarked more easily.
- A rich variety of data can be automatically identified and processed, reducing the needs for re-keying or reformatting.

## How do companies report in XBRL?

1. Collect and prepare source materials such as historical financial statements:
  - a. Determine the scope and amount of detail to put into the XBRL Instance.
  - b. Determine which software you want to use and any assistance needed.
2. Create the company extension taxonomy and Instance document using XBRL-enabled software:
  - a. Input profile data, such as the name of the company and the period being reported.
  - b. Select tags from the US GAAP taxonomy and apply them to the company's financial data.
  - c. Designate the appropriate 'meta data' for the tagged information ('contexts' and 'link bases').
3. Validate the Taxonomy Extension and Instance document to ensure they are XBRL compliant.
4. Publish the documents, e.g., post to the corporate Web site, upload to the SEC's EDGAR database, distribute as a link in a news release.



## How is financial data converted into XBRL?

Public companies are responsible for the complete and accurate tagging of their financial statements. They can either create the tagged documents themselves or turn to a service provider. The most efficient approach is to obtain the assistance of persons experienced in both US GAAP reporting and in using XBRL. Currently these individuals are mostly found among the XBRL International membership, including the major public accounting firms. Training is often available from a reputable services provider or one of the software vendors offering XBRL tools. For forthcoming training events available through XBRL International, **visit [www.xbrl.org/us/events](http://www.xbrl.org/us/events) for details.**

## What software is available to create XBRL tagged business reports?

The current version of XBRL and the US GAAP taxonomies that contain those tags are currently supported in document creation tools from (in alphabetical order) Allocation Solutions, CoreFiling, Fujitsu, Hitachi, Rivet Software, Semansys, SimpleX and UBmatrix.

Earlier versions of XBRL are supported in tools from Blast Radius, CaseWare IDEA, Oracle, SAP and Microsoft. FDIC regulated banks submitting XBRL reports are able to use products from DBI, FinArch, FRS, IDOM, ITI, Fidelity and Jack Henry Associates. Also, tools for software programmers working in XBRL are available from DecisionSoft and Batavia J2R.

Many vendors are now in the process of developing XBRL-enabled software. Vendors have an opportunity to be listed on the XBRL International Web site. XBRL International itself does not offer software tools.

A current listing of vendors' products and service offerings is available at [www.xbrl.org/us/vendors](http://www.xbrl.org/us/vendors)

## How will an end user know the reliability of information in an XBRL tagged report?

A user can have a high degree of confidence that an XBRL file obtained from a Web site via a secure Internet protocol is, at the time of obtaining it, the exact file posted by the owner of the Web site. The meaning of the XBRL tags in the file depends on the meaning of those tags at the time the file was created.

A user looking for confirmation that the XBRL document is correct can check to see if the XBRL document is accompanied by the report of an independent auditor. The Public Company Accounting Oversight Board in a May 25, 2005 Staff Q&A recently noted: "...an auditor may be engaged to examine and report on whether the XBRL-Related Documents accurately reflects the information in the corresponding part of the official EDGAR filings. That engagement is an examination under AT section 101 of the PCAOB's interim attestation standards, Attest Engagement ("AT section 101"), as amended."

## What level of effort is needed to create an XBRL tagged set of statements?

A preparer that has familiarity with the industry, the proper tools and prior experience tagging in XBRL will be able to complete the tagging job in 2 hours per page, although with more complex reports this estimate could increase by a factor of 3 to 4.

Updating an XBRL file for subsequent periods takes less time. Once the XBRL tools, process, and initial tagging are in place, this investment is reused only requiring updates for new tags and financial reporting elements.

## What is the role of XBRL in the corporate reporting supply chain?

Participants in a business information supply chain summarize and exchange information across organizational boundaries.

These participants encompass public and private companies, lenders, investors, regulators, business partners and capital markets. Today, every participant must work with a variety of formats and differing data definitions for the information that they collect, and that they, in turn, must publish in many formats and with different meanings.

XBRL is a common language to be used across the entire supply chain, from reporting individual business events and operating results inside an organization, to reporting to external stakeholders.

## About XBRL-US

XBRL-US is the US based arm of XBRL International Inc., a non-profit consortium of over 400 leading companies, associations and government agencies. XBRL-US is hosted and supported by the American Institute of CPAs, one of the founding members of XBRL International. The XBRL-US Web site contains an up-to-date list of members. Members conduct their work in periodic meetings, conference calls and online. Members benefit from knowledge sharing with leading experts, cross-industry collaboration, awareness of software vendor capabilities and plans and influence on the evolution of XBRL itself.

## Joining XBRL-US

Your organization can enjoy these benefits by becoming a member of XBRL-US. Membership in XBRL US includes membership in the international organization. The Web site [www.xbrl.org/us/join](http://www.xbrl.org/us/join) has information on how to join.

