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Q&A with an expert: XBRL insights from the Director of the FRC's Financial Reporting Lab

By *Dimensions* staff

Phil Fitz-Gerald is the Director of the Financial Reporting Lab at the Financial Reporting Council (FRC), the United Kingdom's regulator of financial reporting. The FRC creates the XBRL taxonomies used in the United Kingdom. Previously, Mr. Fitz-Gerald was the Head of Case Examination and Enquiries at the FRC. In that role, he led the first phase of the FRC's project on improving the quality of reporting at smaller listed and AIM-quoted companies.

Dimensions spoke with Mr. Fitz-Gerald by video call about the Financial Reporting Lab's work with XBRL-tagged financial reporting and his view of the future for XBRL reporting in the United Kingdom and Europe.

What is the role of the Financial Reporting Council (FRC)?

The Financial Reporting Council is the independent regulator for the accounting, auditing, and actuarial professions in the United Kingdom. We set the UK Corporate Governance and Stewardship Codes, as well as other reporting and audit standards; and we monitor and enforce compliance with those standards. In relation to XBRL, we produce the XBRL taxonomies that have been used for the purposes of tax reporting and for the business registrar for about 10 years now. You may well be aware that in the United Kingdom, whilst public companies have not been required to report using XBRL, private companies have been required to produce their tax information in XBRL for a number of years.

What has been the response of private companies to reporting tax data in XBRL?

The system that we have used in the United Kingdom has made it fairly easy for private companies. Actually, they probably do not even know they are doing it a lot of the time because HMRC [the UK tax authority] provides a template for companies to fill out the information, and that automatically tags the information in XBRL. A large number of companies that are required to file with HMRC use that template.

Where does the Financial Reporting Lab fit into all of this?

As I mentioned, the FRC is a regulator. Some parts of the FRC set standards, and other parts of the FRC monitor and enforce against those standards. The Financial Reporting Lab sits slightly separately to the FRC's regulatory activities. What the Lab is looking at is helping companies produce really good financial reporting. We promote best practices. We engage with investors. We ask investors what they are looking for in reporting, and we try to work with companies to deliver that. We are all about providing best-practice examples, practical guidance, and help to companies on reporting.

Over the past few years, as well as looking at specific reporting topics, we have looked at the method of reporting and how technology can be used to further corporate reporting or to help the process of communicating between companies and investors. That is really where we have come across XBRL. We have looked at a number of different technologies. XBRL is one of them. It is one way that information can be passed more easily between companies and investors in a digital format.

When the Financial Reporting Council was created, was it required to establish the Financial Reporting Lab, or was this an internal initiative?

The Lab was an FRC initiative, set up in 2011, so it is a relatively recent development at the FRC. It was felt that there was a need to better understand what investors are looking for in reporting. Clearly, the accounting standards are written in a way that is designed to produce information that is useful to investors. But there is quite a lot of reporting that is not covered in accounting standards. In a lot of the narrative reporting, there is less regulation and less prescription on how you communicate. What we thought would be useful at the FRC was to have a way of asking investors what they thought companies could do to improve reporting. That is really how the Lab was born.

What we try to do in the Lab is create what we call a "safe environment" for companies and investors to discuss their reporting and discuss how they might be able to improve reporting for the benefit of the user.

In other countries, is there anything comparable to the quasi-governmental status of the Financial Reporting Lab? In the United States, for example, there are independent think-tanks and other organisations that serve a similar purpose, but they are not part of any regulator.

It is pretty unique to be attached to a regulator. Being part of the FRC gives us the benefit of providing greater credibility to the reports that we put out. If we make a recommendation in the Lab, companies are more likely to follow it because they know it comes from their regulator. Therefore, it has a level of credibility that other initiatives may not necessarily have, depending on where they are.

There are not many equivalents in the world. Japan has a lab that is very much inspired by ours. Interestingly, a reporting lab has just been set up in Europe:

WHAT THE LAB IS LOOKING AT IS HELPING COMPANIES PRODUCE REALLY GOOD FINANCIAL REPORTING.

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EFRAG [European Financial Reporting Advisory Group] has a reporting lab. They produced their first report (on climate reporting) towards the end of 2019 or the beginning of 2020. So there are some models around, but it is quite unusual.

Even calling it a "lab" is a striking way to position it.

Yes, the idea is that it is a place for companies to experiment.

The Financial Reporting Council has coordinated with the IFRS Foundation in the past. Can you discuss those efforts?

As a regulator of accountants, the FRC seeks to influence the development of IFRS [International Financial Reporting Standards]. Many parts of the FRC will liaise very closely with the IFRS Foundation, seeking to put our views across– we will respond to IFRS consultations.

Of course, in Europe, IFRS are endorsed by EFRAG. We have had, in the past, a key role in the discussions EFRAG has had with the endorsement of International Financial Reporting Standards. In the Lab, we meet with IASB on a regular basis, because the best-practice recommendations that we put out could actually influence the development of standards in the future, and that has proved to be the case with some of the work that we have done in the past.

What is the Lab's involvement with XBRL?

The Lab initiated a project on looking at the different technologies and looking at how those technologies could improve the communications between companies and investors. It started that project about six years ago. It looked at various technologies, including artificial intelligence and blockchain. We are currently looking at video, augmented reality, and virtual reality. But the first technology we looked at was XBRL. It was at a time when the ESEF [European Single Electronic Format] requirements were being developed.

We issued a report on XBRL about three years ago, where we set out what we think the benefits of XBRL are for investors and for the communication of information between companies and investors. That report was useful for explaining what XBRL is and the potential that it provides. Alongside it, the regulation was developing as the ESEF requirement was being developed.

From a personal perspective, I got quite interested in XBRL and ended up becoming a board member of XBRL International, which I am very privileged to be a part of.

You mentioned virtual reality. Are you exploring the use of virtual reality for financial reporting?

Not so much for financial reporting, but probably for broader corporate reporting. Companies are starting to experiment with different technologies for getting across their messages. We saw that some companies are showing their assets in a virtual way. For example, as an investor in an oil company, you

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cannot necessarily visit an oil rig. But you can look at a virtual-reality depiction of that oil rig. So some of these things can be used quite effectively for showing a company's assets and actually allowing the user of that information to make a virtual visit to those assets.

This is particularly interesting now, at a time when we have even more restricted access to a company's assets because of the [coronavirus] lockdowns. So it may become even more relevant.

In the United States, it seems probable that XBRL tagging will be expanded to other parts of financial reporting, such as MD&A discussions and earnings announcements. Do you think that the European Union will ever require XBRL reporting in other areas of financial disclosure?

I can see that happening. The ESEF implementation is a phased approach, so it starts off with the tagging of the primary financial statements, which is not as extensive as the US requirements at the moment, and then by 2022 it will be the block-tagging of the notes. But I think the intention is always to expand that across financial statements and then in the future to cover the more narrative aspects of reporting. I know other jurisdictions are starting to experiment with that.

There is a lot of demand at the moment from investors for good-quality environmental, social, and governance [ESG] information. One of the challenges with that type of information is getting some kind of consistency and comparability. I do think there is an opportunity with XBRL to provide that consistency and comparability. But that is some way off. This is a first step.

What is the best way to communicate to CFOs, financial-reporting professionals, and legal teams that XBRL is truly worth the effort?

Companies are often seeking to get more analyst coverage. Of course, analysts have limited time, so they will tend to take information that can be accessed quickly. In a world where that information is provided digitally, it is very easy for analysts to access information from a much wider population, whether a larger company that gets a lot of analyst coverage anyway or a smaller company that struggles to get analyst coverage. If you provide that information in a digital way, it is there for analysts at the touch of a button rather than having to trawl through paper-based information or wait for data-aggregators to provide the information to them. There is a real benefit for companies in getting their financial information quickly to analysts and getting better coverage.

I think the other benefit is that it enables analysts to do their financial analyses much more quickly than before. That gives them more time to focus on some of the non-financial information, such as how the company regards its employees or considers environmental factors. That information is not delivered using XBRL at the moment and thus requires a bit more effort, but if you are saving time in the financial analysis, you have more time to focus on other aspects of corporate reporting. So there is a benefit for companies as well as investors.

In the United States, XBRL seems to be integrated in every piece of rulemaking coming out of the SEC, and XBRL is part of every discussion about financial reporting. While ESEF is a first step, do you see that eventually happening in the United Kingdom and Europe?

We need to see how the implementation comes through at the end of this year in the United Kingdom and then see how that information is starting to be used by investors. We hear a lot from the United States about the benefits of having information in EDGAR reported in XBRL and how easy it is to scrape, access, and analyse that information. I have seen a number of the tools that have been developed to let analysts do that. We can certainly see the benefits. I think it will become a bigger part of the reporting discussion. But I think we have to see how it goes over the coming years.

What is the Financial Reporting Council most eagerly looking for in the first annual reports filed under the ESEF mandate?

It will be quite interesting to see how the digitisation of corporate information from public companies is going to be used. It will be interesting to see how analysts start using that information and how companies start taking advantage of the new requirements to present their information in a digital way. Rather than asking what the FRC is excited about, we are really interested to see how this can open up communication between companies and investors, and to see how investors use that.

In your view, what are the most important aspects of XBRL tagging that filers need to focus on to avoid errors and submit high-quality XBRL disclosures? What should companies be doing now?

In the Lab, we have been experimenting with tagging information. Once you start doing it, you realise what the challenges are. Nothing is black and white in accounting. There are lots of areas of judgement. The way you label things can vary from company to company. It is not a natural one-to-one relationship between the taxonomy and the accounting choices and labeling that you make in a paper-based system.

The advantage of the implementation as we are doing it at the moment is that it applies only to primary financial statements in year one. That gives companies a chance to get familiar with using the taxonomy and to deal with some of the challenges it presents in a limited subset of their financial statements.

I would encourage companies to start doing that initial tagging exercise and become aware of what the challenges and issues are initially in their primary financial statements. There is plenty of literature out there—you produce some of it yourself at Toppan Merrill—about the common XBRL mistakes that arise. I think that is quite helpful to companies, to flag to them the mistakes that might arise and the effects of them. For example, you add an extra zero and suddenly a million pounds becomes ten million pounds, or positive profits suddenly become negative profits. These are common XBRL errors that can have a huge effect on how your information is analysed.

So I would tell companies to have a go and practice this. Look at the common errors that are frequently published. Learn as you go along, rather than waiting until the last minute when it may be too late to fix.

How are companies initially reacting to the implementation of XBRL? Do they want to take on the tagging themselves, or are they more inclined to seek out a provider with expertise in both XBRL and accounting to ensure they are getting the tagging right? What have you been hearing?

I think there probably is a range of what people think they can use technology for, and there might be some who think, “Actually, I’d rather outsource this.”

However, back in the day with paper-based accounts, you might have received accounting advice, but you still had to own the decisions that you made. If you are using technology such as AI to help you, that is fine, but that should not be a substitute for using your own judgement and taking responsibility for the choices that you have made in your tagging. If someone questions that in the future, you cannot say, "Oh, it was the AI that decided that tag." It does not work like that, in the same way you cannot say that someone else decided to account for something in a particular way and it wasn't you. To my mind, it is the same thing.

I am not saying technology cannot help, but the ownership and responsibility for the XBRL tags must be with the company, and there are different ways of achieving that.

You mentioned that in the Financial Reporting Lab's experiments with XBRL tagging, you experienced some of the challenges in the use of XBRL that filers face. What were they?

There are certain things that are labeled pretty consistently. For example, most companies talk about turnover. That is fairly straightforward in XBRL tagging. But in some of the subcategories of expenses, such as admin expenses, people will call it different things. IFRS allows you to label some things in a different way. Sometimes you cannot naturally map over the tag. Your selection of the tag or an extension involves judgement in many ways.

It was quite an interesting exercise to see and identify where those differences are and think: "Oh, crickey! There's no tag for this. What do I do with this? Do I extend or try to pick a tag as near as possible?" For me, that was the challenge.

Actually using the XBRL taxonomy I found to be fairly straightforward. Being able to access the tags and then see which lines they might apply to is reasonably straightforward. But the different labeling of things, depending on your particular business, was more difficult.

What are the rules about custom tags in the United Kingdom and Europe? That has been a big issue in the United States.

For the ESEF implementation, you can create extensions, but the difference with ESEF is that you have to anchor them to the nearest relevant item in the taxonomy. If you cannot find the specific tag that represents the line item you are talking about, you can label it using an extension, but you need to find the nearest tag to anchor it to.

Do you refer reporting violations for enforcement?

Within the FRC, we have two divisions that may address violations in reporting: a supervision division and an enforcement division. The supervision division supervises company reporting and auditors, thereby similar to aspects of the SEC and the PCAOB in the United States. It reviews company reports and audits.

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> I WOULD ENCOURAGE COMPANIES TO START DOING THAT INITIAL TAGGING EXERCISE AND BECOME AWARE OF WHAT THE CHALLENGES AND ISSUES ARE INITIALLY IN THEIR PRIMARY FINANCIAL STATEMENTS.

If there are more serious issues, we may also refer the matter to our enforcement division or other authorities, such as the Financial Conduct Authority [FCA]. The FRC has enforcement power only over accountants operating in a company, rather than the company itself. We also have enforcement powers over auditors.

We work closely with other authorities in the United Kingdom, such as the FCA. If there is a question of serious fraud, then the Serious Fraud Office might investigate.

The first annual financial reports (AFRs) in XBRL will be filed in early 2021. How many months ahead of time should companies do their XBRL preparation?

You will probably not be surprised to hear me say it: as soon as possible. However, I do think it slightly depends on the company.

One of the things we are encouraging companies to think about is the governance arrangements around this. It is quite useful to lay out a timetable: When will you do your tagging? When will you start making decisions about which tags to use? What kind of governance procedures are needed? What kind of signoffs? At what point will you start using the software, and how will that work with the design of the annual report? One of the things companies need to think about is not just the tagging but also producing the information in HTML, which most companies have not been doing. Most companies have been producing their filings in PDF.

Try to set yourself a timetable: "I need to file in February/March 2021. Let's work back from that." I know some companies have done a trial run based on their last filing. It is a good thing to practice on your December 2019 accounts.

How do you expect the Financial Reporting Council to use the XBRL data in the first annual reports filed in XBRL?

The FRC reviews 200 to 300 filings per year. It is a risk-based approach. We identify priority sectors and review the annual reports. We write to companies if we have any questions about their reporting. The XBRL data will enable us to analyse information more quickly and help us decide which companies to select for review.

Do issuers recognize that the Financial Reporting Council is thinking about XBRL data and tagging selection? Is there an awareness that there are 1,200 AFRs coming your way tagged in XBRL data and that you are going to use machine capabilities to conduct analyses?

It is yet to be determined exactly how we are going to use it. Most people will be aware that providing information electronically means it is not just the investors who are going to use that information but it also has the potential to be useful for regulators. However, it is still a limited implementation initially, being only the primary financial statements.

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Are there any other challenges for issuers that you anticipate in this first set of filings with Inline XBRL?

As I say, I think the main challenge is really planning for it, and realising that it is not a simple process. Accounting is complex, and accounting for large group companies is even more complex. When you add to that the requirement to tag the information and produce it in an xHTML document, there is a lot for companies to think about. Therefore, companies need to start thinking about how they are going to organise themselves to implement this.

How does the Financial Reporting Council view the introduction of the ESEF Inline XBRL requirement?

The FRC has always supported greater digitisation of information, and the United Kingdom has sought to lead in this. The HMRC implementation of XBRL was one of the earliest implementations of XBRL, and it has provided information to the tax authorities that has been very useful to them in the way that this makes it easier to access and analyse information. In relation to the ESEF implementation, it provides a way for analysts to very quickly access and analyse information, so it is very much the first step toward the digitisation of public company corporate communications.

The Transparency Directive requires financial-reporting information to be compiled in national databases, the so-called Officially Appointed Mechanisms (OAMs). Can you explain their role in the United Kingdom's regulatory structure?

The FCA is responsible for the system of filing information in the United Kingdom. The FCA recently brought the National Storage Mechanism in-house. Companies are already required to file to the FCA system. We hope that in the future, this is where people will access filings. The Financial Reporting Lab is already accessing filings in the new system.

How has Covid-19 affected the work of the Financial Reporting Council and the Financial Reporting Lab?

The FRC responded quickly to the Covid-19 issues. We worked with other regulators to provide guidance to companies and auditors on how they could best respond to the crisis. There were certain allowances by the FRC in relation to filing deadlines—there was an extension of filing deadlines for annual reports. The FRC also provided practical help on the areas of accounting that might be affected by Covid-19, such as impairment, key judgements and estimates that companies report, and going-concern disclosures. On the audit side, there are some practical issues about how you get audit evidence when you cannot necessarily do stock takes or be on site for some of your audit testing. We provided some guidance on that.

The Lab produced an infographic that set out the areas of reporting which investors are most focused on. Not surprisingly, investors are focused on how the company is ensuring it has the finances to survive.

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What do you think the ESEF mandate will accomplish in financial reporting?

As I have mentioned before, the implementation of ESEF is a phased approach. The idea of focusing first on primary financial statements was to ensure that it was not a huge burden on companies. Also, the hope was that it would ensure good-quality information, even if it was not extensive information across all of the financial statements or other corporate reporting. It is a first step for the future. You can see that XBRL could be expanded to other areas of financial reporting.

As I say, when companies are looking for more analyst coverage, digital information makes it easier for analysts, and therefore you are more likely to get extra coverage. Companies should take advantage of this.

Companies also more than ever need to keep control of their narrative. In addition to XBRL data, there is a lot of digital information available about companies. Investors are increasingly using third-party data-providers to get information about a company. You can find out quite a lot about a company from information that has not been put out by the company itself. Therefore it is very important for companies to be aware of the data that is available on them and keep control of their own narrative and be sure it is consistent with what others are saying.

In your view, how does the ESEF mandate intersect with auditors and their requirements?

This has yet to be determined.

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