POLICY PAPER

The impact of the digital economy on financial reporting: what strategic challenges face international accounting standard setters? Focus on XBRL as a "standard business reporting language"

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Executive Summary

The new financial reporting environment is the result of the combined influence of three main factors: the digitalisation, financialisation and globalisation of the economy and, more generally, companies. These three phenomena emerged independently but their subsequent interaction triggered a sudden spurt, making their combined action highly disruptive. This new environment has gradually engulfed all areas of human activity and is redefining the economic infrastructure and radically changing the organisation and coordination models within and between companies. It has set in motion what is, most probably, an irreversible trend towards the dematerialisation, digitisation and automation of financial and accounting procedures, making it important to define the related limits and issues.

Developing this "global digitisation" is central to the activities of economic and financial empires such as Google, Apple, Facebook and Amazon. This has become a strategic sector for economic development and especially for European countries, which were slow to react until the European Commission proposed a digital strategy for the single market with a view to creating a true European digital economy.

What impact does the development of this digital financial globalisation have on financial reporting and to what extent does it bring into question accounting standards and the role of the standard setter?

The emergence of big data as a new economic asset class, the use of machine learning models, artificial intelligence and data mining, the creation of a near free market of more than one billion users (all that is needed is an Internet connection), the widespread use of mobile technology (smartphones and tablets), cloud computing, the development of online services and the use of social networks are all contributing to the emergence of this new digital economy. The advent of virtual currencies and blockchains, which allow for the complete dematerialisation of financial transactions, add the finishing touch to this incredible economic and societal revolution.

In the face of such developments, Ghai and Rapp (2016) propose transforming financial analysis to make it more oriented towards the digitised production of real-time, on-demand information, integrating non-financial and predictive information.

This new financialised digital society causes a disruptive environment, which creates potential difficulties for national and international accounting standard setters.

The growth of peer-to-peer platforms is significantly transforming the markets formerly occupied by large companies. Digitalisation speeds up the shift towards dematerialised network companies, which undermines the traditional accrual basis accounting model.

Companies, defined as productive organisations founded on an asset base and holding physical assets, are increasingly being replaced by network organisations, value-added partnerships or virtual enterprises, the essential logic of which is to outsource as much as possible. In this type of organisation, the bulk of the value created is often derived from intangible assets, which are difficult to identify and value from an accounting perspective as they are held by increasingly hazy legal structures. The fair value model is therefore often the most appropriate, even though it is no secret that it is limited in many ways.

From this point of view, the main international accounting standards (IFRS and US GAAP) have acknowledged the change caused by financial globalisation and the digitalisation of the economy with the concept of fair value. Advances in the digitisation of financial reporting point to other possible improvements. Initiated by Miller and Modigliani, this value model is based on the idea that a company's value is the sum of the current value of future income generated by existing assets and growth opportunities. Correct measurement of this income requires a change in the accounting model which is made possible by the digitisation of financial reporting. This should make it possible to better integrate risk and the measurement of cash flows associated with growth opportunities. Appropriate taxonomy can help boost better integrated and strategic reporting by reducing many of the difficulties inherent in consolidation technology.

Overall, progress in the digitisation of financial reporting thanks to taxonomies and the roll-out of iXBRL should contribute to improved information for investors and greater transparency in the financial markets through the “tagging” of strategic narrative information and faster dissemination of reporting data.

This new disruptive environment also largely explains the worldwide development of the XBRL standard, which allows investors, analysts and other stakeholders to receive machine-readable information without the need for reprocessing.

The impact of digitisation on financial reporting has therefore already been acknowledged by economic and financial players, most of whom have adopted XBRL as the standard business reporting language. XBRL first came into widespread use in the United States, before spreading to the rest of the world. Supported by the IASB and the FASB, XBRL has become a major strategic concern given its mandatory use for companies listed in the United States, in many countries around the world (including India and China), and in Europe from 2020 onwards. XBRL has become a true global business reporting standard, used in more than 40 countries in different financial (banking, insurance and tax) and non-financial (environmental and societal reporting) areas.

The generalisation of reporting in XBRL format poses strategic problems such as the choice and role of taxonomies, the openness of the language and the role of extensions, and whether or not to tag "non-financial" data.

Thus far, academic research on the issue of reporting in XBRL has mainly focused on the United States, but it is beginning to appear in Europe.

Initially focused on the voluntary disclosure of US companies in the pre-implementation period of the XBRL standard, the research goes on to reveal controversial results, but indicates an improvement overall in the comparability of financial statements in the post-implementation period of XBRL in the United States. Numerous studies show that the quality and reliability of information in XBRL improves over time with a reduction in accounting work and discretionary choices. The impact of XBRL reporting is positive with respect to improving the efficiency of the financial market. However, more diffuse effects have been noted regarding the asymmetry of information between companies and investors.

Two major issues have proved controversial: taxonomies and extensions.

These taxonomies associated with US GAAP or IFRS must serve the same purpose, and identify and define the tags that can be used when they stem from a radically different approach to standardisation, i.e. a rules-based approach for US GAAP and a principles-based approach for IFRS. Many stakeholders, including national standard setters, have expressed concern about the possible contradiction between the creation of a principles-based standard and the definition of a taxonomy that "restricts" concepts in a dictionary.

Furthermore, the open nature of XBRL allows the user to create extensions leading to debate about whether they improve or degrade the quality of the information.

With regard to extensions, the SEC and the IASB are in favour of granting full freedom to companies, whereas ESMA has taken a more restrictive stance, while recognising that companies should be given a certain degree of autonomy in this area. ESMA will require that the extensions be anchored to concepts contained in the IFRS taxonomy.

The SEC has compiled and analysed the XBRL reports over the 2009-2016 period. The average rate of extensions was 20%. The analysis reveals a steady and gradual decline in the use of extensions by large companies and there is no systematic evidence of selection errors or unjustified use of these extensions.

Dirk Beerbaum (2014) tested the theory that the extension rate of IFRS filers is much higher than that observed among US GAAP filers. He found that the number of tags under US GAAP compared to the IFRS taxonomy is three times higher, but that only part of the US GAAP taxonomy is used meaning that the average rate of extensions used is relatively similar.

With regard to the potential conflict between the IFRS taxonomy and the accounting principles approach, the IASB (IASB, 2016) noted the concern of some standard setters that the IFRS taxonomy could conflict with the principles approach and hinder the standard setter. On the contrary, the IASB believes that data modelling via taxonomy can improve the clarity and consistency of the wording of IFRS and thus contribute to the more consistent implementation of IFRS.

Based on a literature review, Dirk Beerbaum and Maciej Piechocki (2016) examined the potential conflict between principles-based standards and the creation of structured electronic reports. According to their work, the XBRL taxonomy serves only to specify the structure of financial information, regardless of whether it is rules-based or principles-based. It is merely an information transmission protocol that supports data modelling. For these two authors, the hypothetical conflict between taxonomy and the principles-based approach is minor.

Given the rapid evolution of digitalisation in Europe and worldwide, national regulators will inevitably consider the strategy to be adopted. Should we take advantage of these new digital reporting capabilities and extend them to other players, given that French companies that publish financial statements in IFRS will be obliged to use them?

What position should the French accounting standards authority adopt in this respect, given that the United Kingdom, Belgium, Italy and the Netherlands have already gone fully digital under XBRL? Will these countries not gain a strategic advantage by having better prepared their transition to a digital European financial market?

Similarly, has Europe provided sufficient impetus overall to remain a major player on the international scene?