

SEC Adopts Rules Requiring Filing of Financial Statements in Interactive XBRL Format

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On January 30, 2009, the Securities and Exchange Commission (the “Commission”) published a release adopting new rules (the “Final Rules”) that will require issuers reporting under U.S. GAAP or International Financial Reporting Standards (“IFRS”) to provide their financial statements to the Commission in eXtensible Business Reporting Language (“XBRL”), an interactive data format.¹ Interactive data files will be filed as exhibits that supplement, but do not replace, the financial statements otherwise required to be filed. XBRL filing is designed to improve the usefulness of financial information submitted to the Commission by making it possible to download financial data directly into spreadsheets and other applications. The Final Rules have been adopted largely as proposed in May 2008,² with a handful of technical changes and one major adjustment: the limitations on liability for errors in the XBRL data file will be phased out completely after two years for each issuer and eliminated altogether in 2014.

I. Background

The Final Rules are the culmination of a multi-year process undertaken by the Commission to promote the use of interactive data, and mirror similar steps taken by other U.S. and foreign regulators. In 2005, the Commission instituted a voluntary program under which companies have been encouraged to submit interactive data files. Some other regulators have also taken steps toward the use of interactive data. In the United States, federal banking regulators have required the use of XBRL for quarterly “call reports” since 2005. Outside the United States, the Adopting Release lists 20 countries that require XBRL

¹ SEC Release Nos. 33-9002; 34-59324; 39-2461; IC-28609 (Jan. 30, 2009) (the “Adopting Release”). The Adopting Release is available on the Commission’s website at <http://www.sec.gov/rules/final/2009/33-9002.pdf>.

² SEC Release Nos. 33-8924; 34-57896; 39-2455; IC-28293 (May 30, 2008) (the “Proposing Release”). The Proposing Release is available at the Commission’s website at <http://www.sec.gov/rules/proposed/2008/33-8924.pdf>.

or have instituted voluntary or pilot XBRL programs, although the Commission is among the first to make XBRL filing mandatory.³

XBRL is an interactive data format that makes a company's financial statements machine-readable so they can be analyzed and compared using other software applications. Because it allows financial data to be downloaded directly into spreadsheets and similar applications, XBRL filing is expected to enable investors, analysts and the Commission staff to capture and analyze financial information more quickly and at lower cost.⁴

To create an XBRL interactive data file, elements in the financial statements must be identified with "tags." For this purpose, the Commission has prompted the development of a standard list of tags, called a "taxonomy," for U.S. GAAP financial statements, and another taxonomy has been developed for IFRS.⁵ The Final Rules contemplate that the taxonomies that are applicable to Commission filings will be specified in the EDGAR Filer Manual, and will be updated from time to time.⁶

A fundamental issue in the use of XBRL is the tension between the comparability of tags used by different issuers and the customization of tags, referred to as "extension," to meet the needs of particular issuers. Under new Rule 405 of Regulation S-T, an issuer must match a data element in its financial statements with an appropriate tag from the most recent

³ The Adopting Release lists Australia, Belgium, Canada, China, Denmark, France, Germany, Ireland, Israel, Japan, Korea, Luxembourg, the Netherlands, New Zealand, Norway, Singapore, Spain, Sweden, Thailand and the United Kingdom.

⁴ In parallel with the adoption of the Final Rules, the Commission has recently announced plans to replace the EDGAR system with the Interactive Data Electronic Applications (IDEA) system. The IDEA system, which is designed to facilitate the use and analysis of information submitted to the Commission in interactive data format, will at first supplement and then eventually replace the EDGAR system.

⁵ XBRL is an open-source standard that includes two principal building blocks – the XBRL Specification – which specifies the structure of the language and how to create tags – and XBRL taxonomies, which are dictionaries of standard tags. The taxonomy for U.S. GAAP was developed by XBRL U.S. under an agreement with the Commission in consultation with numerous parties including the staff of the Financial Accounting Standards Board, issuers in the voluntary filer program, accounting firms and the Commission staff. The taxonomy for IFRS is maintained by the International Accounting Standards Committee Foundation.

⁶ Changes to the EDGAR Filing Manual are adopted via Commission rulemaking, but since such changes relate solely to agency procedures or practice, publication for notice and comment is not required under the Administrative Procedures Act. The Commission states in the Adopting Release that "we anticipate giving advance notice before requiring use of an updated list of tags." Adopting Release, text following note 284.

standard list of tags specified by the EDGAR Filer Manual, except that (a) an issuer must change the label if the tag is appropriate in all respects except the label (for example, changing the label from “net revenues” to “operating revenues” to match the issuer’s traditional format financial statements) and (b) an issuer must use a new tag if no standard tag is appropriate for reasons other than the label.

II. The Interactive Data File

Under the Final Rules, a company will be required to prepare and file two versions of its financial statements with the Commission. The first version, which the rules call the “related official filing,” will consist of the financial statements formatted and filed as they are today, in ASCII or HTML format. The XBRL rules do not change any requirements applicable to the related official filing. The second version will be filed as an exhibit to the related official filing and posted on the company’s website, and will consist of the machine-readable “interactive data file” in XBRL format that corresponds to the financial statements and financial statement schedules in the related official filing.

New Rule 405 of Regulation S-T governs the form and content of the interactive data file. Under the rule, the interactive data file will be required to contain a complete set of information for all periods required to be presented in the corresponding data in the issuer’s financial statements and all required financial statement schedules in the related official filing. The Final Rules will not, however, require interactive data submissions for other financial statements that may be required of filers, including those provided pursuant to Rules 3-05, 3-09, 3-14, and 3-16 of Regulation S-X. Similarly, the interactive data requirements will not apply to pro forma financial statements prepared under Article 11 of Regulation S-X or to financial statements of a target in a business combination transaction. The interactive data file must contain all data elements (i.e., text, line item names, monetary values, percentages, numbers, dates and other labels) contained in the issuer’s financial statements in the related official filing, and may not omit or summarize information contained in the related official filing. Filers will not be permitted, for example, to exclude comparative information for prior periods.

Rule 405 will require companies to provide tagged data for the face of the financial statements, the footnotes to the financial statements and the related financial statement schedules. (The Commission’s voluntary program, in contrast, did not require tagging of the footnotes or financial statement schedules). To provide additional time for filers to become familiar with the tagging process, however, in each filer’s first year of interactive data reporting, each footnote will only be required to be tagged as a single block of text. Beginning with its second year, a filer will be required to tag each significant accounting

policy within the significant accounting policy footnote, each table within a footnote, and within each footnote, each amount (i.e., monetary value, percentage and number).⁷

III. Phase-In Period for the Interactive Data Requirements

The Final Rules will be phased in over a three-year period, as summarized in the following table.

Category of Filer	Mandatory Interactive Data Filing Requirements Begin With:	<i>Example: Calendar-Year Companies</i>
U.S. and Foreign Large Accelerated Filers using U.S. GAAP with a worldwide public float above US\$5 billion ⁸	<ul style="list-style-type: none"> • <i>U.S. Issuers:</i> Form 10-Q for the first fiscal quarter ending on or after June 15, 2009 • <i>Foreign private issuers:</i> Form 20-F or 40-F for the first fiscal year ending on or after June 15, 2009 	<ul style="list-style-type: none"> • <i>U.S. Issuers:</i> Form 10-Q for the quarter ended June 30, 2009 • <i>Foreign private issuers:</i> Form 20-F for the year ended December 31, 2009
All other Large Accelerated Filers using U.S. GAAP	<ul style="list-style-type: none"> • <i>U.S. Issuers:</i> Form 10-Q for the first fiscal quarter ending on or after June 15, 2010 • <i>Foreign private issuers:</i> Form 20-F or 40-F for the first fiscal year ending on or after June 15, 2010 	<ul style="list-style-type: none"> • <i>U.S. Issuers:</i> Form 10-Q for the quarter ended June 30, 2010 • <i>Foreign private issuers:</i> Form 20-F for the year ended December 31, 2010
All other filers using U.S. GAAP and IFRS	<ul style="list-style-type: none"> • <i>U.S. Issuers:</i> Form 10-Q for the first fiscal quarter ending on or after June 15, 2011 • <i>Foreign private issuers:</i> Form 20-F or 40-F for the first fiscal year ending on or after June 15, 2011 	<ul style="list-style-type: none"> • <i>U.S. Issuers:</i> Form 10-Q for the quarter ended June 30, 2011 • <i>Foreign private issuers:</i> Form 20-F for the year ended December 31, 2011
Companies that become subject to the reporting requirements after June 15, 2011	<ul style="list-style-type: none"> • <i>U.S. issuers:</i> First Form 10-Q • <i>Foreign private issuers:</i> First Form 20-F or 40-F 	

⁷ Similarly, in year one, each financial statement schedule will be required to be tagged as a single block of text; the specific amounts within the financial statement schedule will be required to be tagged beginning with the second year.

⁸ For this purpose, “worldwide public float” means the aggregate worldwide market value of the voting and non-voting common equity held by non-affiliates. Public float calculations for purposes of the XBRL rules will be determined as of the last business day of the second fiscal quarter of a Company’s most recently completed fiscal year. This is the same date used for determining accelerated filer status.

As described below, electronic filers will also be required to submit interactive data files as exhibits to their Securities Act registration statements. Under the phase-in provisions, a company will not be required to submit an interactive data exhibit to a Securities Act registration statement until it has filed its first quarterly or annual report required to include an interactive data file. For a U.S. issuer, the first filing subject to the XBRL filing requirement will be a quarterly report on Form 10-Q rather than an annual report on Form 10-K. Foreign issuers reporting under Canadian GAAP, or under other foreign accounting principles with a reconciliation to U.S. GAAP, will not be subject to the XBRL filing requirements.⁹

IV. Filings Subject to the Interactive Data Requirements

An electronic filer will be required to submit an interactive data file exhibit with the following filings.

- Annual Reports on Forms 10-K, 20-F and 40-F.
- Quarterly Reports on Form 10-Q.
- Reports on Forms 8-K and 6-K that include updated or revised financial statements. This would apply, for example, when an issuer files a Form 8-K with revised financial statements to reflect a discontinued operation, or a change in reportable segments. For a foreign private issuer, this would apply when it files a Form 6-K with interim financial statements incorporated by reference into a Securities Act registration statement to meet the nine-month updating requirement of Item 8.A.5 of Form 20-F. It would not, however, apply when a foreign private issuer files a Form 6-K with interim financial statements that are not otherwise required to be filed.¹⁰

⁹ The interactive data requirements for IFRS issuers will apply only to issuers that prepare financial statements in accordance with IFRS as issued by the IASB. The Final Rules will not require or permit foreign private issuers that prepare their financial statements in accordance with a variation of IFRS to provide interactive data. Adopting Release at note 77.

¹⁰ See new General Instruction C.6 to Form 6-K (“the Interactive Data File would be required only as to such ... current interim financial statements [included pursuant to the nine-month updating requirement of Item 8.A.5 of Form 20-F] regardless whether the Form 6-K contains other financial statements”).

- Securities Act registration statements that include financial statements in the filing rather than incorporating them by reference.¹¹ The interactive data exhibit will not be required until a price or price range has been determined, and will be required for later amendments only if the financial statements have changed.

In a change from the original proposal, registration statements for an initial public offering will not be required to include an interactive data file. Similarly, issuers will not be required to include an interactive data file when using Forms 10, 20-F or 40-F to register under the Exchange Act.

V. Website Posting Requirement

To make interactive data more broadly accessible, new Rule 405(g) of Regulation S-T requires that each filer covered by the interactive data requirements provide the same interactive data that it is required to provide to the Commission on its corporate website, if it has one. Posting may not be by means of a link to the Commission's website.¹² The interactive data must be posted on the same calendar day it is filed (or if earlier, on the calendar day it was required to be filed). Website posting will not be required until the end of any applicable grace period that applies to the submission of the data to the Commission. Each interactive data file must remain on the electronic filer's website for at least 12 months.

VI. Grace Period for Initial Filings

The interactive data file will be an exhibit to the related official filing, and generally will be required to be filed at the same time as the rest of the filing to which it relates. However, recognizing the additional effort required the first time a filer tags its financial statements, the Final Rules include a 30-day grace period for the first interactive data exhibit. A similar grace period is provided for the first interactive data exhibit required to fully tag the footnotes to the financial statements. Pursuant to the grace period, an electronic filer will be permitted to file the missing exhibit by amendment within 30 days of the earlier of the date on which the related official filing was made or the date on which it was required to be made. The interactive data file exhibit must be submitted as an amendment to the

¹¹ Where the financial statements are incorporated by reference, the related interactive data file will be filed as an exhibit to the report containing the incorporated financial statements.

¹² See Adopting Release at text following note 207 ("To help further our goals of decreasing user cost and increasing availability, we will not allow companies to comply with the Web posting requirement by including a hyperlink to the Commission's Web site").

related annual or quarterly report, and may not be submitted using Form 8-K or 6-K.¹³ During the grace period, the electronic filer will continue to be eligible for short-form registration and the Rule 144 resale safe harbor.

VII. No Requirement for an Audit or Formal Review by Auditors

The Final Rules do not require an audit of the interactive data file. Nor will the filer's auditors be required to apply to the interactive data file several procedures that might otherwise require them to review it.¹⁴ In sum, the Final Rules do not require any formal audit or review of the interactive data file by an independent party, and the Adopting Release indicates clearly that data tagging provides "no additional basis for auditor liability."¹⁵ Unlike XBRL data submitted under the voluntary program, however, there will be no legend cautioning users that the data have not been audited.

Although the Final Rules do not require a formal auditor review of the interactive data file, the Adopting Release notes that issuers may obtain third-party assurance under PCAOB Interim Attestation Standard AT Section 101, Attest Engagements. In connection with the Commission's voluntary program, the PCAOB staff has provided guidance for auditors on how to perform an attest engagement on interactive data.¹⁶ The Adopting Release indicates that the PCAOB is aware of sentiment in favor of specific attestation standards for interactive data.

VIII. Officer Certifications and Disclosure Controls and Procedures

The Final Rules include amendments to Exchange Act Rules 13a-14 and 15d-14 to exclude the interactive data file from the officer certification requirements. The Final Rules, however, do not exclude the interactive data file from the issuer's obligation to maintain and evaluate its disclosure controls and procedures under Exchange Act Rule 13a-15 and 15d-15

¹³ Unlike other amendments of annual or quarterly reports, an amendment that does no more than submit the interactive data file will not be required to include certification by the CEO and the CFO.

¹⁴ AU Sections 550 (which requires an auditor to read information accompanying the audited financial statements and bring any material inconsistencies with the audited financial statements to the attention of the company), 711 (which specifies procedures for review of filings under federal securities statutes) and 722 (which codifies SAS 100's procedures for the review of interim financial information) will not apply to the interactive data file.

¹⁵ See Adopting Release at text accompanying note 258.

¹⁶ See PCAOB Staff Questions & Answers Regarding XBRL Financial Information Furnished Under the XBRL Voluntary Financial Reporting Program on the EDGAR System, Question 8 (May 25, 2005)(the "PCAOB Interactive Data Attestation Guidance").

or the related disclosure requirements under Item 307 of Regulation S-K and Item 15 of Form 20-F.¹⁷ A company accordingly will need to consider its procedures with respect to interactive data when evaluating its disclosure controls and procedures and disclosing the results of that evaluation. On the other hand, the Adopting Release makes clear that the process of preparing and submitting an interactive data file does not fall within the definition of internal control over financial reporting and accordingly need not be included in an issuer's review of its internal control over financial reporting and the related auditor attestation pursuant to Section 404 of the Sarbanes Oxley Act of 2002.¹⁸

IX. Consequences of Failure to File or Post Interactive Data When Required

Subject to the hardship exemptions described below, a filer that does not make the required interactive data submission, or that fails to post the interactive data on its website, by the required due date will not be able to use short-form registration on Forms S-3, F-3 or S-8 until the required interactive data is filed and posted. Similarly, until the interactive data is filed and posted, the filer will also be deemed not to have current public information for purposes of the resale exemption safe harbor provided by Rule 144. Once a filer complies with the interactive data submission and posting requirements, it will immediately regain its eligibility for short-form registration and the Rule 144 safe harbor.

X. Hardship Exemptions

Consistent with the Commission's treatment of other electronic filing requirements, the Final Rules include temporary and continuing hardship exemptions for the inability to timely submit interactive data.¹⁹ Rule 201 of Regulation S-T sets forth the procedures for a temporary hardship exemption, which will be granted automatically and does not require action by the Commission staff. An electronic filer that experiences unanticipated technical

¹⁷ The Adopting Release indicates that interactive data will "fall within the definition of 'disclosure controls and procedures.'" Adopting Release at text accompanying notes 279 and 280.

¹⁸ The Adopting Release notes that over time some issuers may integrate interactive data technology into their business information processing. "If the integration occurs, the preparation of financial statements may become interdependent with the interactive data tagging process and an issuer and its auditor should evaluate these changes in the context of their reporting on internal control over financial reporting. However, this evaluation is separate from the preparation and submission of the interactive data file, and as such the results of the evaluation would not require management to assess or an auditor to separately report on the issuer's interactive data file provided as an exhibit to a filer's reports or registration statements." See Adopting Release at text accompanying note 278.

¹⁹ Exchange Act Rule 12b-25 will not be available for late filings of interactive data exhibits. The Final Rules amend Rule 12b-25 to require such matters to be addressed solely via the hardship exemption procedures.

difficulties that prevent timely preparation and submission or website posting of an interactive data file will be eligible for a temporary hardship exemption providing an additional six business days to submit and post the file. During the six business day period, the failure to file or post the interactive data exhibit will not result in loss of eligibility for short-form registration or the Rule 144 resale exemption. To take advantage of the exemption from submitting an interactive data exhibit, the filer must file, in lieu of the interactive data file, a document that sets forth a required legend.²⁰ Under Rule 202 of Regulation S-T, an electronic filer may also apply for a continuing hardship exemption if the required interactive data exhibit cannot be filed or posted without undue burden and expense. A continuing hardship exemption requires action by the Commission staff.

XI. Liability for Interactive Data

A. Overview

If a data element is improperly tagged in the interactive data file, potentially significant errors may result when the file is processed and viewed. Similarly, if there is a material inconsistency between the figures contained in the related official filing and those contained in the interactive data file, investors that rely primarily on the interactive data file when making investment decisions may suffer damages that would not have arisen had they relied on the traditional format financial statements set forth in the related official filing.

In addressing liability, the Final Rules distinguish between errors contained in interactive data files submitted during the first two years a company is subject to the interactive data filing requirements, and those submitted after that date. During the first two years, while the Commission will retain the ability to bring enforcement actions based on violations of its rules, the Final Rules provide limitations on liability that should significantly reduce the risk of successful private litigation for good faith errors in the interactive data file. After the initial two-year period, the liability limitations will cease to apply, and the interactive data will be subject to the same liability provisions as the related official filing. The liability limitations will be phased out altogether on October 31, 2014.

The decision to eliminate the liability limitations after the second year represents a significant change from the Proposed Rules, which contained no sunset provisions. Although commenters overwhelmingly supported limiting liability for the interactive data file, a handful of commenters suggested that liability be revisited or increased after an initial

²⁰ The required legend is as follows “IN ACCORDANCE WITH THE TEMPORARY HARDSHIP EXEMPTION PROVIDED BY RULE 201 OF REGULATION S-T, THE DATE BY WHICH THE INTERACTIVE DATA FILE IS REQUIRED TO BE SUBMITTED HAS BEEN EXTENDED BY SIX BUSINESS DAYS”. The temporary hardship exemption for the website posting requirement does not require an issuer to post a legend or notice. The exemption requires only that the file be posted within the six business day period.

period. In explaining its decision to adopt a sunset provision, the Commission argued that phasing out the limitations after a specified period “improves the balance between avoiding unnecessary cost . . . and encouraging accuracy . . . because it recognizes that issuers and service providers likely will grow increasingly skilled at and comfortable with the tagging requirements.” One of the five Commissioners, Commissioner Aguilar, argued that even a 24-hour limitation on liability would be too long, and dissented from the Commission’s decision adopting the liability limitations.²¹

B. Limitation of Liability During the First Two Years

Rule 406T provides certain exemptions from liabilities under the federal securities laws for any interactive data file²² submitted during the first two years after a filer is subject to the mandatory XBRL requirements. In particular:

- The interactive data file is subject to liability under Rule 10b-5 (as well as Section 17(a)(1) of the Securities Act and Section 206(1) of the Investment Advisers Act of 1940), but not if the issuer made a good faith²³ effort to comply and corrected the error promptly²⁴ after becoming aware of it. By its terms, Rule 406T is not limited to tagging errors. The exemption also appears to be available

²¹ See Remarks of Commissioner Luis A. Aguilar (“New technologies should not be encouraged at the expense of investor protection . . . While I understand that the limitations on liability sunset as to each filer on a rolling 24 months basis similar to the phase in, I am concerned about the exposure to investors during that time. I would not want to expose investors for even 24 hours, much less 24 months . . . It departs from our best traditions, and shackles investors with the risks and costs arising from errors and misstatements in interactive data, even though issuers control the process of preparing the disclosure and are in the best position to ensure its accuracy and reliability”).

²² In the proposed rules, the Commission limited liability for the interactive data file, but indicated that “interactive data in viewable form” that was identical to the information in the related official filing would not benefit from the liability limitations. The Final Rules eliminate this distinction, and the Adopting Release confirms that “[i]nteractive data in viewable form . . . will reflect the related interactive data file and, as a result, . . . should be treated in the same manner as the related interactive data file in regard to a . . . failure to correctly tag an interactive data file that results in a failure of the interactive data in viewable form to reflect the related official filing.” See Adopting Release at text accompanying note 235.

²³ As originally proposed, the exemption would have required showing of a “good faith and *reasonable*” attempt to comply with the requirements of Rule 405 of Regulation S-T. In response to comments, the Final Rules require only a “good faith” attempt, which the Adopting Release indicates is equivalent to “not having the *scienter* required for purposes of the anti-fraud provisions.”

²⁴ For this purpose, “promptly” is defined as “as soon as reasonably practicable under the facts and circumstances at the time.” Rule 11 of Regulation S-T also includes a non-exclusive safe harbor that provides that a correction made by the later of 24 hours or 9:30 a.m. on the next business day after the filer becomes aware of the need for the correction is deemed promptly made.

where the interactive data file contains numerical or other errors that do not appear in the financial statements in the related official filing, as long as the issuer made a good faith attempt to comply with Rule 405 and corrects the errors promptly upon becoming aware of them.

- The interactive data file is not subject to liability under Section 11 or 12 of the Securities Act or Section 18 of the Exchange Act. The interactive data file will not be deemed “filed” or “part of a registration statement or prospectus” for purposes of those sections. As a result, an investor that invests based on a material misstatement or omission contained in the interactive data file that is not also present in the related official filing will have no cause of action against an issuer or underwriter under Section 11 or 12 of the Securities Act or Section 18 of the Exchange Act.

C. Liability for Errors After the Initial Two-Year Period

Interactive data filed after the initial two-year period will become subject to the same liability provisions as the related official filing. As a result, a misstatement or omission in the interactive data file may give rise to potential liability under Section 11 or 12 of the Securities Act or Section 18 of the Exchange Act and, if the plaintiff can demonstrate the defendant acted with *scienter*, under the anti-fraud provisions.

Materiality of errors in the interactive data file that do not appear in the related official filing. Where an alleged misstatement or omission appears in the interactive data file but not in the related official filing, a threshold question will be whether the correct information in the related official filing renders the alleged misstatement or omission immaterial. A misstatement or omission is material if there is a substantial likelihood that a reasonable investor would view it as significantly altering “the ‘total mix’ of information made available.”²⁵ Where the total mix of information made available includes both accurate and misleading statements, the materiality of the misleading statements depends upon whether the accurate statements deprive the misleading statements of their deceptive edge. As the Supreme Court noted in *Virginia Bankshares v. Sandberg*:

While a misleading statement will not always lose its deceptive edge simply by joinder with others that are true, the true statements may discredit the other one so obviously that the risk of real deception drops to nil. . . . But not every mixture with the true will neutralize the deceptive. If it would take a financial analyst to spot the tension between the one and the other, whatever is misleading will remain materially so, and liability should follow.²⁶

²⁵ *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976).

²⁶ *Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1097 (1991).

Applying these principles to a case in which the EDGAR version of a prospectus contained an error not present in the printed version distributed to investors, the Second Circuit Court of Appeals concluded in *DeMaria v Andersen*²⁷ that where there are two versions of a prospectus, an investor can only reasonably be expected to read one version, and therefore liability can arise if either version contains a material misstatement or omission.²⁸ Taken together, *DeMaria* and *Virginia Bankshares* suggest that a correct related official filing may not be sufficient to neutralize an error in the interactive data file.

Due Diligence Procedures. Against this backdrop, it will be particularly important for underwriters and others with a potential Section 11 due diligence defense to consider what steps are necessary to demonstrate that they have carried out a reasonable investigation with respect to the interactive data file.

For purposes of the Section 11 due diligence defense, a registration statement has two parts: portions that are prepared upon the authority of an expert, and portions that are not. For portions of the registration statement that are not prepared upon the authority of an expert, an underwriter must demonstrate that, after a “reasonable investigation,” it reasonably believed the registration statement was true and free of material omissions.²⁹ For portions made upon the authority of an expert, which include the audited financial statements, no reasonable investigation is required to establish the defense, so long as the defendant had no reasonable ground to believe, and did not believe, that there was a material misstatement or omission.³⁰

²⁷ *DeMaria v. Andersen*, 318 F.3d 170, 179 (2d. Cir. 2003) (“Because we cannot reasonably expect an investor to read more than one version of a company’s prospectus, we agree with the SEC that liability under § 11 may lie either where one version of a prospectus is materially misleading or where different versions of a prospectus, taken together, are materially misleading”).

²⁸ In *DeMaria*, the Court of Appeals concluded that the error in the EDGAR version was outweighed by other correct information in the EDGAR version and affirmed the district court’s dismissal of the Section 11 claim. 318 F.3d at 182.

²⁹ See Section 11(b)(3)(A) of the Securities Act (defendant must prove that “as regards any part of the registration statement not purporting to be made on the authority of an expert ... he had, after reasonable investigation, reasonable ground to believe and did believe, at the time such part of the registration statement became effective, that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading”).

³⁰ See Section 11(b)(3)(C) of the Securities Act (defendant must prove that “as regards any part of the registration statement purporting to be made on the authority of an expert ... he had no reasonable ground to believe and did not believe, at the time such part of the registration statement became effective, that the statements therein were untrue or that there was an omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading”).

Although a properly prepared interactive data file will contain all of the information that appears in the audited financial statements in the related official filing,³¹ the interactive data file itself will not be subject to a separate audit. As a result, there is at least a potential concern that a court might question whether the financial information in the interactive data file is “made upon the authority of an expert.” We believe it would inappropriately elevate form over substance to hold that audited financial information ceases to be expertized when it is accurately transposed into the XBRL file.³² To the extent information in the interactive data file is identical to the audited information in the related official filing, that information should retain its expertized nature when made available in XBRL format.³³ We expect market participants will seek confirmation of this point from the Commission.³⁴

Whether or not the portion of the interactive data file containing information from the audited financial statements is considered expertized, an underwriter will still want to carry out a reasonable investigation of the unaudited information in the interactive data file. This would include any interim unaudited financial information in the file. It would also include portions of the XBRL tag other than the label and amounts, including information regarding context and the relationship between different data elements, to the extent this information is not contained in the audited financial statements in the related official filing.

Performing due diligence on an interactive data file may prove to be a burdensome and complex exercise. Although error detection software may ease the burden, because the interactive data file is a machine-readable file, errors in tagging data may not always be readily apparent from reviewing a rendered version of the interactive data file.³⁵ Whereas an

³¹ See new Rule 405 of Regulation S-T.

³² On the other hand, errors in the interactive data file that do not appear in the audited financial statements could not fairly be said to be made on the authority of an expert. In that situation, an underwriter will need to demonstrate that it carried out a reasonable investigation.

³³ This is consistent with the SEC’s statement that the interactive data file provides “no *additional* basis for auditor liability,” because the auditor in a situation where the interactive data file is identical to the related official filing will already be subject to liability on the basis of the related official filing. Reproducing the same errors in the XBRL file would not provide an “additional” basis for liability. See Adopting Release (emphasis added) at text accompanying note 258.

³⁴ Even if an underwriter were required to show a reasonable investigation, ensuring that steps are taken to “tick and tie” the information in the XBRL file to the audited financial information in the related official filing should allow an underwriter to convincingly argue that it has undertaken a reasonable investigation by confirming conformity with the audited financial statements.

³⁵ See XBRL U.S., U.S. GAAP Taxonomy Preparer’s Guide ¶8.1.2 (“US GAAP Taxonomy Preparer’s Guide”)(“Creating a human-readable format of the instance document, called rendering, is usually

underwriter today can satisfy itself that the EDGAR version of a document is accurate by reviewing a proof of the HTML filing, certain tags in the interactive data file may produce errors only when used to extract and analyze data in other contexts. Given the technical expertise necessary to review the interactive data file and its relationship to the financial statements, underwriters may wish to consider seeking auditor assurance on the interactive data file, either by expanding the “tick and tie” procedures in a SAS 72 comfort letter to cover the file or via a separate attest engagement under Interim Attestation Standard AT 101 that follows the PCAOB’s guidance on procedures for verifying the interactive data file.³⁶ Even if underwriters do not require an auditor attestation, the PCAOB’s guidance on procedures to be carried out by auditors performing an attest engagement on XBRL data may be a helpful guide to steps that can be taken to verify the accuracy of the interactive data file.

necessary during the final review process . . . However, reading the rendered instance will not identify all errors that may exist in the extension taxonomy or instance document. In practice, technical support is usually required to generate detailed reports on the extension taxonomy, or several different renderings of the instance document (for example, showing element attributes in addition to their labels, or showing the instance using calculation relationships rather than only presentation relationships”).

³⁶ See PCAOB Interactive Data Attestation Guidance. The PCAOB recommends that an auditor consider “the following examination procedures . . .:

- Compare the rendered XBRL-Related Documents to the information in the official EDGAR filing, and agree the corresponding content.
- Determine whether the content in the XBRL-Related Documents conforms to the SEC . . . content requirements.
- Determine whether the XBRL-Related Documents (and the related taxonomy documents, as necessary) conform to the SEC . . . program format requirements. To accomplish this, the auditor should consider the following procedures:
 - Test whether the data elements (i.e., text and line item names and associated values, dates and other labels) in the XBRL-Related Documents reflect the same information as the corresponding official EDGAR filing (i.e., the HTML or ASCII version).
 - Verify that the data elements in the corresponding official EDGAR filing have not been changed, deleted, or summarized in the XBRL-Related Documents.
 - Evaluate whether the XBRL-Related Documents comply with the appropriate XBRL specification and EDGAR-supported XBRL taxonomies.
 - Evaluate whether any company extensions of the taxonomy are consistent with the SEC . . . format requirements, including conformity with XBRL specifications.
 - Test whether data elements in the XBRL-Related Documents are matched with appropriate tags in accordance with the applicable taxonomy. [...]
- Obtain a representation letter from management that includes a statement that the XBRL-Related Documents comply with SEC requirements.”

* * *

Questions regarding the interactive data rules can be directed to your regular contacts at the firm or to any of our partners and counsel listed under “Capital Markets” on our website, <http://www.clearygottlieb.com>.

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