

FEI CEO's 2008 Top Challenges for Financial Executives

As financial executives of both public and private companies absorb the events and happenings of 2007 and look ahead at what's in store for them in 2008, FEI CEO and President **Michael P. Cangemi** has compiled the following List of the Top Challenges for 2008 — in no particular order:

■ **Fair Value/Subprime Market Crisis/Derivatives.** Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standard 157, *Fair Value Measurement*, was originally required to be adopted for financial statements for fiscal years beginning after Nov. 15, 2007 and interim periods within those fiscal years.

However, on Nov. 14, 2007 — one day before it was supposed to have been applied and after various appeals from FEI members and other constituents — FASB delayed the implementation of FAS 157 for certain non-financial assets and liabilities (the comment period on the related FASB staff position that would finalize this is expected to close in January).

Fair value is determined to be a market-based measurement, and the standard sets up a three-level hierarchy for determining the fair value based on "observable" inputs (active markets, etc.) and "unobservable" inputs.

Though not enough to have prevented the crisis, some, including FASB Chairman Robert Herz, have said the disclosures for financial instruments provided by early adopters of FAS 157 helped provide information needed by users on these complex instruments. Certainly, FAS 157 is easier to apply for instruments with active markets. For those instruments without active markets, it's not as clear; in these cases, there

are many implications for preparers, auditors and regulators.

And with a new quasi-standard-setter on the scene, the Center for Audit Quality (CAQ), issuing white papers on these matters, standards (and questions) continue to proliferate. Stay tuned.

■ **Global Convergence of U.S. GAAP and IFRS.** Are the U.S. markets ready for principles-based standards? The first step towards answering that question is the U.S. Securities and Exchange Commission (SEC) decision in November to eliminate the U.S. generally accepted accounting principles (GAAP) reconciliation for foreign private issuers that file financial statements in International Financial Reporting Standards (IFRS), as promulgated by the International Accounting Standards Board (IASB).

Now on the agenda is consideration of the comments on the SEC concept release to allow U.S. issuers to file financials in IFRS.

On the flip side, we await another decision: Is the European Union (EU) ready to accept U.S. GAAP without reconciliation to IFRS by non-EU based companies that list in the EU? And, will the EU continue to adopt IFRS with carve-outs, or will the EU follow IFRS, "as published by IASB?"

With the IASB Small and Medium-Sized Entity (SME) standards also out for consideration, this is not just a public company issue. As FASB and IASB move toward global accounting standard convergence, the SME standard may likely keep pace with, rather than trail, the standards for public companies.

Additionally, other priority issues include: strengthening the IASB's funding, governance and oversight as it increasingly moves towards becoming "the" global

standard-setter in accounting.

■ **Complexity in Financial Reporting.** Later in 2008, the SEC Advisory Committee on Improvements to Financial Reporting (CIFR) expects to finalize its recommendations. Its Chairman, Robert Pozen, said the committee is trying to come up with solutions that are practical, doable and workable that intend to: make financial information more useful, reduce restatements, clarify the process for providing guidance on accounting standards, reduce complexity and promote U.S. GAAP and IFRS convergence.

There may be some interplay with the recommendations of the U.S. Treasury Advisory Committee on the Auditing Profession (ACAP), also due out this year, as well as Treasury's study on restatements. See the ACAP reference in the next item, "Audit Profession."

■ **Audit Profession.** Charged with examining the sustainability of a strong and vibrant auditing profession, the Treasury Department's ACAP is considering, among other things, the auditing profession's ability to cultivate, attract and retain talent; ensure audit quality for investors; audit market competition and concentration and the impact of the independence and other professional standards on the U.S. market. But how will the findings impact preparers and audit fees? Auditing Standard No. 5 (AS5) is a step in the right direction (see "Internal Controls" item), but there is more that can be done to establish a quality audit at a reasonable price:

a. Encourage expansion of types of audit firms in order to expand the number of firms that can provide certain services at lower fees.

b. Expand the number and types of professionals to lessen current load and

reduce turnover.

c. Study the various elements of tort reform.

d. Need for change in auditors' and inspectors' behavior. This includes a shift toward professional judgment rather than feeling pressured to audit to detailed rules. As IFRS become a reality, this is essential. Additionally, the audit profession should continue to consider global convergence of internal control standards through a thoughtful, deliberative approach to audit standard-setting as it affects both private and public company audits.

■ **XBRL** (eXtensible Business Reporting Language) and interactive financial reporting. The SEC has clearly made XBRL a priority and continues to reinforce in all its communications that it favors a path toward adoption. Expect even more momentum in this direction in 2008 in advance of potential leadership changes at the SEC in an election year.

By now, the full set of U.S. GAAP taxonomies has been released for public comment by April 4. Also, the SEC plans roundtables across the country to get preparer and user feedback.

As the SEC moves forward with IFRS, the taxonomies for both U.S. GAAP and IFRS must also be considered together to ensure convergence occurs from a technology standpoint as well. Besides financial reporting, there are potential benefits in the areas of internal financial analysis and continuous auditing.

■ **Business Combinations.** IASB and FASB jointly worked on a project regarding major changes to business combination accounting. The standard was released Dec. 4, and applies to fiscal years ended after Dec. 15, 2008.

Among the myriad of changes: contingent assets and liabilities associated with an acquisition will be recognized at the date of the acquisition at fair value, with any subsequent changes reflected in earnings (not as an adjustment to goodwill); intellectual property R&D would be capitalized at the date of acquisition; acquired accounts receivable would be recognized at fair value (that is, no separate allowance for doubtful accounts); and all acquisition-related costs paid to third parties would be expensed as incurred.

Significantly, this standard will be the first test of U.S. acceptance of a major FASB/IASB joint standard.

■ **Internal Controls.** 2007 marks the first year that AS5 and related SEC management guidance will be applied by all public companies. Since its enactment in 2002, Section 404 of the Sarbanes-Oxley Act has been publicized as the most extensive and costly component of the act.

Though AS5 and the complementary management guidance has refocused on a top-down, integrated approach toward the external audit, both accelerated and non-accelerated filers are only starting to see whether or to what extent this will impact their companies. Whether or not there is a trickle-down effect of these changes on the audits of private companies also remains to be seen.

A new factor in the mix is the Committee of Sponsoring Organizations of the Treadway Commission's (COSO) Guidance on Monitoring Internal Control, which is expected to be issued as an Exposure Draft this quarter, and finalized by June 30.

■ **Healthcare.** With a Presidential election in November, candidates continue to debate proposed changes to health-care policy. Early discussions have focused mainly on expanding coverage for children and adults, with considerable differences over who should be covered, what the benefits should be and how it should be paid for. The continuing rise of costs to employers for medical and prescription drugs has not been given the attention it deserves, and financial executives should consider challenging candidates about how such costs can be better managed.

■ **Corporate Taxation.** Corporate tax initiatives continue to proliferate in Washington. The tax community worries that Congress may pursue efforts to eliminate or greatly curtail "deferral," the policy that allows U.S. multinationals to defer paying taxes on foreign-source income until it is brought stateside. Congress may pursue other anti-business tax proposals as well — such as placing deductibility limits on deferred compensation; codifying the economic substance doctrine;

eliminating LIFO accounting — to "pay for" individual tax breaks and/or increased government spending. On a side note, eliminating LIFO would solve one U.S. GAAP/IFRS difference, since IFRS does not allow LIFO.

■ **Rating Agency Regulation.** The recent meltdown of the subprime mortgage market has generated a great deal of discussion about the role played by credit rating agencies in rating mortgage-backed securities. Several policy-makers have voiced their concerns with the apparent conflict of interest, and have questioned whether Congress and/or the SEC should ramp up their oversight of the credit rating agencies. Legislative and regulatory proposals could follow.

■ **IRS Policy of Restraint/Privilege.** The Internal Revenue Service (IRS) may reconsider the scope of its "policy of restraint" towards requesting companies' tax accrual workpapers. In light of recent tax reserve disclosures mandated by FIN 48 — and the subsequent Congressional investigation into whether such reserves indicate improper tax avoidance — the IRS may decide to broaden the circumstances under which it requests such workpapers.

The business community won an important victory in the Textron case, in

Issues discussed here should be high on financial executives' agendas. They are on FEI technical committee agendas. To get involved with an FEI committee, visit the FEI website.

which a U.S. District Court held that Textron's tax workpapers were protected by the work product doctrine and therefore need not be turned over to the government. However, should the case be appealed, the U.S. Circuit Court could very well overturn (or narrow the scope of the District Court's decision.

— *With contributions from Cheryl de Mesa Graziano, Ellen M. Heffes, Grace Hinchman, Edith Orenstein, Mark Prysock and Bill Sinnett*