

The 11 prominent financial reporting issues that require special attention in 2008 are:

1. Fair Value, the Subprime Market Crisis, and Derivatives
2. Convergence of U.S. GAAP and IFRS
3. Complexity in Financial Reporting
4. Audit Profession
5. XBRL and Interactive Financial Reporting
6. Business Combinations
7. Internal Controls
8. Health Care
9. Corporate Taxation
10. Rating Agency Regulations
11. IRS Policy of Restraint and Privilege

The purpose of this publication is to summarize key regulatory, technical, and professional developments in the corporate governance and accounting fields and to provide links to additional information. Readers seeking a more in-depth analysis of a topic should review the information referenced in the hyperlinks and not rely on the descriptions included in this communication.

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FEI: Top Challenges for Financial Executives in 2008

Deloitte has prepared this special edition to summarize and provide resources to address the top challenges facing financial executives in 2008, as outlined by Financial Executives International (FEI).

The full text of the FEI release and links to the resources referenced throughout are available on the Center for Corporate Governance Web site at www.corpgov.deloitte.com/us/specialedition.

1. Fair Value, the Subprime Market Crisis, and Derivatives

The Financial Accounting Standards Board (FASB) has delayed adoption of its Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurement*, for certain nonrecurring, nonfinancial assets and liabilities (e.g., goodwill, property, asset retirement liabilities, and restructuring liabilities). Fair value is a market-based measurement; the standard sets up a three-level hierarchy for determining fair value based on observable inputs (e.g., quoted market prices and market-based information) and unobservable inputs (e.g., no market data).

Considerations

While SFAS 157 has been deferred for certain nonfinancial assets and liabilities, it applies to financial instruments held by all entities in fiscal years beginning after November 15, 2007 (January 1, 2008, for calendar-year-end companies). Financial instruments must also be disclosed according to their level in the hierarchy. Financial executives should be in a position to determine the appropriate valuation of financial instruments and classification in the hierarchy upon adoption of SFAS 157.

Resources

- **Deloitte:** *Financial Reporting Alert 08-7*, "SEC Advises Registrants to Further Explain Fair Value in MD&A."
- **Deloitte:** *Heads Up*, February 20, 2008, "Valuation Resource Group Discusses Six Topics at February 1, 2008, Meeting."
- **Deloitte:** *Heads Up*, February 15, 2008, "FASB Partially Defers and Limits Scope of Statement on Fair Value Measurements."
- **Deloitte:** *Financial Reporting Alert 08-4*, "Turmoil in the Credit Markets: The Importance of Comprehensive and Informative Disclosures."
- **Deloitte:** *Financial Reporting Alert 08-1*, "SEC Issues Letter Clarifying Accounting Ramifications of Accelerated Efforts to Mitigate Subprime Crisis."
- **Deloitte:** *Audit Committee Brief*, Fourth Quarter 2007.
- **Deloitte:** *Global Economic Outlook 2008*.

- **Deloitte:** *Financial Reporting Alert 07-5*, "CAQ Update – Key Accounting Issues and the Credit Environment: Center for Audit Quality Issues Final White Papers."

2. Convergence of U.S. GAAP and IFRS

Are the U.S. markets ready for principles-based standards? The SEC decided in November 2007 that foreign private issuers filing financial statements based on International Financial Reporting Standards (IFRS), as defined by the International Accounting Standards Board (IASB), no longer need to reconcile those statements with U.S. generally accepted accounting principles (GAAP). While comments on the SEC concept release to allow U.S. issuers to file IFRS financials are being considered, we await other decisions: Is the European Union ready to accept U.S. GAAP without reconciliation to IFRS? Will the European Union continue to adopt IFRS with carve-outs, or will it follow IFRS as published by the IASB?

Considerations

Because U.S. companies may be able to use IFRS for public reporting purposes, they should be thinking about whether IFRS is right for them. The following are a few questions for these companies and their audit committees to consider:

- Has the company inventoried its current IFRS reporting requirements, if any?
- What is the level of IFRS knowledge in the company, both domestically and globally?
- Are the company's competitors already reporting under IFRS or is there an expectation that they would switch to IFRS if given the choice?
- What would be the impact on the company of an IFRS requirement in the United States?
- Has the company assessed the cost and benefits of adopting IFRS?
- Does the company have an 18–24 month plan if it elects to adopt IFRS?

Resources

- **Deloitte:** Dbriefs webcast replay from February 20, 2008: "International Financial Reporting Standards: Strategies for Adopting a Single Set of Standards."
- **Deloitte:** *International Financial Reporting Standards for U.S. Companies: Implications of an Accelerating Global Trend*.
- **Deloitte:** *Heads Up*, December 18, 2007, "SEC Holds Roundtables on IFRSs."
- **Deloitte:** *Heads Up*, August 17, 2007, "The Shift toward IFRSs and Its Impact on U.S. Companies."

3. Complexity in Financial Reporting

The SEC Advisory Committee on Improvements to Financial Reporting (CIFIR), established in July 2007, is expected to finalize its recommendations this summer. Its chairman, Robert Pozen, said the committee is trying to develop

practical ways to make financial information more useful, reduce the number of restatements, provide guidance on accounting standards, reduce complexity, and promote U.S. GAAP and IFRS convergence.

Considerations

CIFIR released a progress report for public comment in February that summarizes its proposals and preliminary ideas for reducing the complexity of financial reporting and increasing the usefulness of the financial information provided to investors. Given the current complexity of financial reporting, audit committees should work with management and the auditors to assess whether the financial statements are informative and transparent.

Resources

- **Deloitte:** *Heads Up*, February 19, 2008, "DeCIFiRing Complexity – SEC Advisory Committee Releases Progress Report."
- **Deloitte:** *Heads Up*, January 18, 2008, "FASB Releases U.S. GAAP Codification for Verification."
- **SEC:** SEC Advisory Committee on Improvements to Financial Reporting Web site.
- **Deloitte:** *Heads Up*, December 20, 2007, "Highlights of the 2007 AICPA National Conference on Current SEC and PCAOB Developments."
- **Deloitte:** *Audit Committee Brief*, Third Quarter 2007.

4. Audit Profession

The U.S. Treasury Advisory Committee on the Auditing Profession (ACAP), which convened in October 2007, is charged with examining the sustainability of a strong auditing profession. The committee is considering:

- The auditing profession's ability to attract, cultivate, and retain talent
- Improvements in audit quality for investors
- Audit market competition and concentration and the impact of the independence and other professional standards on the U.S. market
- The organizational structure, financial resources, and communication standards of the auditing profession.

Considerations

The committee is expected to issue a final report this summer. Deloitte intends to continue supporting the ACAP through its ongoing dialogue with regulators and representation on the committee. We understand that the important topics under consideration by the CIFIR and ACAP, as well as the Treasury's restatement study, are best considered holistically following the conclusion of all these efforts.

Resources

- **GAO:** *GAO Audits of Public Companies: Continued Concentration in Audit Market for Large Public Companies Does Not Call for Immediate Action*.
- **U.S. Treasury:** ACAP Web site.

- **U.S. Treasury:** ACAP webcast replay from February 4, 2008, meeting. Refer to the testimony of Barry Salzberg, chief executive officer of Deloitte LLP.

5. XBRL and Interactive Financial Reporting

XBRL (eXtensible Business Reporting Language) remains on the horizon for U.S. issuers. The SEC has made it a priority and continues to reinforce that it favors public comments toward adoption. The full set of U.S. GAAP taxonomies (standard list of terms) are available on the XBRL U.S. Web site. The SEC held roundtables across the country to obtain feedback from preparers and users.

Considerations

The focus on this financial reporting tool has intensified. Seventy companies, representing more than \$2 trillion in market value, have participated in the SEC's XBRL Voluntary Financial Reporting Program, submitting annual, quarterly, and other reports with interactive data in addition to their conventional filings. As the SEC moves toward adopting IFRS, implementation of XBRL for U.S. GAAP and IFRS must be considered together to allow convergence from a technology standpoint. In addition to having a positive impact on financial reporting, the SEC expects XBRL to be beneficial in the areas of internal financial analysis and continuous auditing.

The SEC's CIFIIR committee recommended a phased approach to XBRL in its draft progress report of February 19, 2008.

Resources

- **XBRL:** XBRL U.S. Web site.
- **Deloitte:** *Heads Up*, February 19, 2008, "DeCIFIring Complexity – SEC Advisory Committee Release Progress Report."
- **Deloitte:** *Heads Up*, December 20, 2007, "Highlights of the 2007 AICPA National Conference on Current SEC and PCAOB Developments."
- **Deloitte:** *Heads Up*, December 10, 2007, "XBRL U.S. GAAP Taxonomy Made Available for Public Comment."

6. Business Combinations

The FASB recently completed the second phase of a project to reconsider the accounting for business combinations. Two accounting standards, SFAS 141(R), *Business Combinations*, and SFAS 160, *Noncontrolling Interests in Consolidated Financial Statements*, an amendment of ARB No. 51, were issued in December 2007. These represent the most significant convergence efforts with the IASB to date.

As a result of these standards and other accounting changes, contingent assets and liabilities associated with an acquisition would be recognized at the date of the acquisition at fair value, with any subsequent changes reflected in earnings rather than goodwill; intellectual property research and development would be capitalized at the date of acquisition; acquired accounts receivable would

be recognized at fair value; and all acquisition-related costs paid to third parties would be expensed as incurred.

Considerations

These accounting standards would further elevate the role of fair value and significantly change the accounting for business combinations and noncontrolling interests. The standards are a meaningful step toward global accounting convergence. Audit committees should further consider the impact on their financial statements and the potential volatility in the income statement in periods following a business combination.

Resources

- **Deloitte:** *Heads Up*, December 12, 2007, "Major Changes to Business Combination Accounting as FASB and IASB Substantially Converge Standards."
- **Deloitte:** Dbriefs webcast replay from December 17, 2007: "Statements 141(R) and 160: An Overview of New Guidance on Accounting for Business Combinations and Noncontrolling Interests in Consolidated Subsidiaries."
- **Deloitte:** *Accounting for Business Combinations, Goodwill, and Other Intangible Assets – A Roadmap to Applying Statements 141 and 142.*

7. Internal Controls

Auditing Standard No. 5 (AS 5) and related SEC management guidance was applied to all public companies for the first time in 2007. Although AS 5 focuses on a top-down, integrated approach to external audits, filers are still determining its impact. Whether these changes will be adopted by private companies remains to be seen.

A new internal control factor is the Committee of Sponsoring Organizations of the Treadway Commission's (COSO) exposure draft, *Guidance on Monitoring Internal Control*, which is expected to be finalized by June 30.

Considerations

COSO believes that the monitoring component is often underused by organizations of all sizes.

"This guidance more fully develops the monitoring component of COSO's Internal Control – Integrated Framework," said COSO Chairman Larry Rittenberg. "The guidance is appropriate for organizations of any size or structure to improve the quality of their internal controls systems for multiple business purposes, but especially those dealing with reporting requirements under the U.S. Sarbanes-Oxley Act of 2002, Section 404."

Financial executives should consider reviewing the discussion document and use the final guidance in their continued Section 404 efforts. Areas most susceptible to weaknesses in recent audits include inventory, tax accounting, and revenue recognition.

Resources

- **Deloitte:** Dbriefs webcast replay from January 31, 2008: "Improving Internal Controls: Management's Process and Auditing Standard No. 5."

- **Deloitte:** Insights podcast: “Leveraging the New Sarbanes-Oxley 404 Guidance: A Refined Approach to SOX.”
- **COSO Web site** – View the press release and discussion document regarding the new guidance.

8. Health Care

With the presidential election in November 2008, candidates are focusing on changes to the health care system. Each has developed a plan to expand coverage, and each has a different view on who should be covered, what the benefits should be, and how the program should be financed. The rise in costs to employers for medical treatment and prescription drugs has not been given the attention it deserves.

Considerations

Financial executives should understand, anticipate, and be prepared to manage potential cost implications of alternative programs.

Resources

- **Deloitte:** *Needed: Five Transformational Changes to Cure the U.S. Health Care System.*

9. Corporate Taxation

Congress continues to review corporate tax initiatives and there is concern that it may eliminate or greatly curtail “deferral,” the policy that allows U.S. multinational corporations to defer paying taxes on foreign-source income until it is brought stateside. Other corporate tax proposals Congress may pursue to compensate for individual tax breaks and increased government spending include limiting the deductibility of deferred compensation, codifying the economic substance doctrine, and eliminating LIFO.

Considerations

Executives should stay current on corporate tax reform proposals in 2008. Executives should also note that if LIFO is eliminated, it resolves one significant difference between U.S. GAAP and IFRS.

Resources

- **Deloitte:** *Financial Reporting Alert 08-6, “Recent Tax Ruling Requires Entities to Reconsider Their Tax Positions Related to Executive Compensation.”*
- **Deloitte:** *Tax News & Views*, October 25, 2007.
- **House of Representatives:** *Tax Reduction and Reform Act of 2007.*
- **U.S. Treasury:** “Approaches to Improve the Competitiveness of the U.S. Business Tax System for the 21st Century.”

10. Rating Agency Regulations

The recent credit crisis has raised questions regarding the role of the credit-rating agencies in rating mortgage-backed securities. In response to the apparent conflict of interest, Congress and the SEC may increase their oversight of the credit-rating agencies.

Considerations

The SEC released its final implementation rules for the Credit Rating Agency Reform Act in June 2007. Congress’s new law gives the SEC more formal regulatory oversight of the credit agencies. With the subprime credit crisis, there is the potential for more regulatory initiatives that may require rating agencies to respond. As Congress, the SEC, and the Treasury continue to look into the agencies’ role, financial executives should look for potential legislative or regulatory proposals that may have an impact on their ratings. The SEC is examining credit-rating firms and may propose changes this spring to increase disclosure of conflicts of interest and establish different rating systems for different categories of assets, according to Erik Sirri, the SEC’s director of trading and markets.

Resources

- **SEC:** “SEC Votes to Adopt Final Rules to Implement the Credit Rating Agency Reform Act of 2006.”

11. IRS Policy of Restraint and Privilege

FASB Interpretation No. (FIN) 48’s required tax reserve disclosures and Congress’ investigation into whether these reserves indicate improper tax avoidance have generated significant discussion and analysis by the IRS as it considers broadening the scope of its “policy of restraint” toward requesting a company’s tax accrual workpapers. The business community won an important victory in the *Textron* case, in which the IRS was denied such access. The U.S. District Court held that the tax workpapers fell under the work product immunity doctrine and did not need to be turned over to the government. The IRS has appealed the district court’s order.

Considerations

Notwithstanding the general policy of restraint, taxpayers remain wary that the IRS may increase the frequency with which it asks them to disclose uncertain tax positions included in their FIN 48 disclosures. Financial executives and tax specialists should become familiar with the IRS policies regarding requests for workpapers. Moreover, it may be a good time to review the company’s FAS 109/FIN 48 documentation process to confirm that workpapers properly label documents as privileged and the files do not contain unnecessary documents.

Resources

- **Deloitte:** *Heads Up*, January 29, 2008, “Tax Accrual Workpapers – Caught between a Rock and a Hard Place.”
- **Deloitte:** Dbriefs webcast replay from January 14, 2008: “FIN 48 and FAS 109 Tax Accrual Workpapers: Caught between a Rock and a Hard Place.”