

FEI CEO: 2010 Top Challenges for Financial Executives

As financial executives absorb the events of last year and assess the coming year, Financial Executives International's CEO and President Marie N. Hollein has compiled the following list of the *Top Challenges for 2010* (in no particular order).

■ **Economic Recovery and the U.S. Fiscal Outlook.** Though most economists believe the economy is headed in the right direction and indicators are hopeful, unemployment levels remain extremely high and cash is still hard to come by. Serious mid- and long-term fiscal issues are apparent as the debt level hovers around the \$12 trillion mark. The public's heightened attention to the U.S. debt levels will complicate matters for policymakers as they push ahead with their progressive legislative agenda and business leaders work to maintain a competitive U.S. business environment.

In FEI's most recent CFO outlook survey, respondents noted economic improvements but were hesitant to declare the recession over, or soon to be. Meanwhile, companies continue to restructure in light of contractions in the job market and ultimately will determine how realignments can provide opportunities for future growth.

■ **Health-Care Reform.** Health care will continue to be a critical issue this year as Congress debates the merits of reform. In the FEI survey, CFOs said they anticipated an 8-percent increase in health-care costs at their companies for most of 2010. To offset rising costs, nearly 58 percent said their companies are considering increasing their employees' share of health benefits costs. Another 20 per-

cent are mulling a decrease in the quality and scope of employee packages.

While legislative reform will likely come in 2010, the long-term impacts on companies and their ability to design health coverage tailored to their employees' needs and their company's mission will last for years. A number of the proposals offered in Congress would mandate that employers offer health insurance to employees as part of their benefits package.

In the FEI survey, while 98 percent said their companies provide health-care coverage, 65 percent did not believe such a requirement should be mandated by the federal government. Additionally, 58 percent of the CFOs indicated that reduction in long-term growth of health-care costs for businesses and government was their number one priority when evaluating the value of health-care legislation.

It appears, unfortunately, that early estimates of proposals working through Congress will have no reversal in cost and, in some cases, the cost of health care will continue to increase faster than inflation.

■ **Employee Benefits.** Companies will continue to assess their employee benefits offerings as tough economic conditions persist and benefits costs continue rising. In the FEI survey, companies have reduced 401(k) matches and the number of weekly work hours, implemented forced vacations, froze or closed pension plans or reduced the percentage of carry-over vacation days.

Though the market has stabilized, pension plan funding is still a consideration as a number of plans maintain a funded status below federally mandated thresholds created in the Pension Protec-

tion Act of 2006 (PPA). This will affect companies' balance sheets and income statements. Those with pension plans maintaining a low-funded status should consider the need to locate cash.

■ **Financial Regulatory Reform.** With Democrats in the majority and a mid-term election on the horizon, Congress is considering major financial regulatory reform legislation. The financial crisis spurred debate on an array of regulatory issues including monetary policy, credit-rating agencies, compensation, financial products, capital market regulation and resolution authority and insurance. While many reform efforts are directed at the financial services industry, regulatory changes are likely to be broad and impact all industries and sectors.

Of specific interest is legislation designed to regulate the over-the-counter derivatives markets, which could greatly affect companies' working capital. Under the legislation, the majority of derivatives products will be standardized and forced onto exchanges and required to be centrally cleared, adding additional margin and capital requirements for each contract. Some exemptions for corporate end-users legitimately managing risk will likely be provided in the end.

However, this legislation will fundamentally change the playing field of the derivatives markets, and no one can be sure of the ultimate effects of enacting such sweeping legislation.

■ **Global Convergence of U.S. GAAP and IFRS.** Though the financial crisis diverted attention from U.S. companies' adoption of International Financial Reporting Standards (IFRS), all eyes are back on the U.S. Securities and Exchange

Commission's next steps on its proposed IFRS roadmap. The SEC received more than 200 comment letters from a wide variety of constituents, expressing broad support for a single set of high-quality globally accepted accounting standards.

Other observations were that progress on the current FASB/IASB Memorandum of Understanding efforts should be completed, improvements in interpretation and enforcement consistency across countries should be addressed, FASB's ongoing role should be clarified and the effect of IFRS accounting changes for differing regulatory purposes (i.e. tax and utility regulation) should be more fully considered.

Operational considerations include changes to accounting systems and contractual agreements, corporate governance considerations, litigation contingencies and human capital readiness.

Will 2010 mark the year the SEC moves forward with a date certain, and how and when will it impact private companies? Since IFRS for SMEs was released last year, private companies are still learning whether the standards can be implemented at their organizations, as well as accepted by their bankers and financial-statement users in lieu of U.S. GAAP. Regardless of when decisions are made, the anticipation and need for education for all types of companies continues.

■ **Financial Instruments.** FASB and IASB will continue to develop a comprehensive model for accounting for financial instruments, including hedge accounting, but each started deliberating separately, planning on a subsequent joint meeting to reconcile differences. Further, FASB expects to issue early this year one comprehensive proposed Accounting Standards Update that addresses the measurement, classification and impairment of financial instruments, as well as hedge accounting.

Meanwhile, IASB — in response to the European Union — has decided to complete its deliberations on the project in three phases. Phase one has been completed with the issuance of IFRS 9 Financial Instruments. Phase two on impairment has resulted in an exposure document on amortized cost with com-

ments due on June 30, 2010. And phase three on hedge accounting is expected to result in an Exposure Draft in the first quarter of 2010.

Various constituents have expressed concern with the differences in classification categories (i.e. fair value changes in net income versus other comprehensive income) as well as concern related to "leap-frogging" timetables. Board members have responded by reaffirming convergence efforts through increased joint meetings. FASB is participating with IASB in an Expert Advisory Panel (EAP) that will advise the boards on operational issues surrounding IASB's expected cash flow approach and FASB's approach for determining credit impairments.

■ **Financial Statement Presentation.**

This joint IASB and FASB Memorandum of Understanding project sets out significant changes to the structure and presentation of the basic financial statements, including a move to organize the components of the statement of financial position, comprehensive income and cash flows by major activities: Business, financing, income taxes, discontinued operations and equity.

In October 2009, the boards tentatively decided to include an analysis of the changes in balances of all significant asset and liability line items and present information about re-measurements in the financial statements. With regard to presentation of cash flow, the boards chose to retain the proposal that an entity present its cash flows using the direct method. The boards also tentatively decided that an entity should not aggregate income and expense items by function and by nature.

A key concern of preparers relates to system changes that will result should the direct cash flow statement be required. An Exposure Draft for comment is expected to be released in the second quarter of 2010, with the final standard slated for 2011.

■ **Revenue Recognition.** Another major joint IASB-FASB initiative, this project aims to clarify the principles for recognizing revenue and to create a joint revenue recognition standard for U.S. GAAP and IFRS that can be applied con-

sistently across various industries and transactions. The boards tentatively decided that an entity should allocate the transaction price to segments of a contract rather than to individual performance obligations. When segmenting a contract, an entity should consider when the promised goods and services are transferred to the customer, the margins for those goods and services, and materiality.

The proposed standards focus on an entity assessing whether control has been transferred to the customer. This will have a major impact on company financial statements. An Exposure Draft is expected this year.

■ **Business Taxation.** Major tax reform seems unlikely this year, though the 2003 "Bush tax cuts" are set to expire this year so numerous tax policies will be debated. In February, financial executives should keep on eye on the Obama administration's FY 2011 budget proposal as well as a report from the President's Tax Reform Subcommittee of the President's Economic Recovery Advisory Board's (PERAB).

This subcommittee plans to present "options for tax reform" to the president, and this year's budget proposal will likely contain several significant tax proposals. Obama's FY 2010 budget submission called for "reform" of the U.S. tax rules relating to foreign source business income and also explicitly called for repeal of the LIFO (last-in, first-out) accounting method.

Congress may pursue these and other anti-business proposals this year so the business community should be alert. A focus on corporate and effective tax rates will likely garner attention in 2010, as well as individual tax rates and many other tax-policy issues that impact pass-through entities. Any discussion of tax policy at this time will be further complicated by the economic climate, the record-high federal budget deficit, and the mid-term elections. Tax risk management is a "one-to-watch" item.

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