by Ellen M. Heffes

FEI CEO's 2007 Top 10 Financial Reporting Challenges

As companies absorb all of the financial reporting changes for 2006 financial reporting — and look ahead — FEI CEO and President Colleen Cunningham has compiled the following list of the Top 10 Financial Reporting Challenges for 2007:

1. Internal Controls. The U.S. Securities and Exchange Commission (SEC) and Public Company Accounting Oversight Board (PCAOB) are working on revised guidance for implementing Section 404 of the Sarbanes-Oxley Act. It is expected that this new guidance will more clearly articulate how companies and auditors might take a more risk-based approach to its implementation.

2. Uncertain Tax Positions. FIN 48 "Accounting for Uncertainty in Income Taxes – an Interpretation of FASB Statement No. 109," will be effective for 2007 reporting. Many companies have experienced implementation issues associated with this Interpretation, so be sure to adopt its provisions carefully.

3. XBRL. The SEC has made eXtensible Business Reporting Language (XBRL) a priority. Expect more momentum in 2007 as more companies voluntarily adopt and the SEC continues to prioritize XBRL.

4. Fair Value. FAS 157, "Fair Value Measurement," will be required to be adopted for financial statements for fiscal years beginning after Nov. 15, 2007 and interim periods within those fiscal years. This standard establishes a framework for measuring fair value and expands disclosures.

Fair value is determined to be a market-based measurement, and the standard sets up the hierarchy for determining the fair value based on "observable" inputs (ready markets, etc.) and "unobservable" inputs. The devil is in the details in determining "unobservable" inputs. The standard requires the use of a "market participants" approach rather than an "entity specific" approach. This will need to be carefully implemented.

5. Servicing Assets and Liabilities. FAS 156, "Accounting for Servicing of Financial Assets – an Amendment of FAS 140," is effective at the beginning of the first fiscal year that begins after Sept. 15, 2006. This standard requires an entity to recognize a servicing asset or a servicing liability each time it undertakes an obligation to service by entering into a servicing contract in certain situations.

6. Complexity in Financial Reporting. The level of restatements (over 10 percent of registrants) implies a level of complexity in the existing reporting model that requires subject matter experts on staff for every accounting area. This is not always practical — particularly for smaller companies — so we are seeing more and more restatements due to simple errors in applying standards.

Additionally, large companies and the largest audit firms with dedicated and proficient subject matter staff, including at the national office level, have also had previous decisions restated due to differing interpretations of complex GAAP. Various organizations, including FEI, have been calling for a special commission to be set up to review the underlying issues and present recommendations to reduce complexity and improve the reporting model. Financial Accounting Standards Board (FASB) Chairman Robert Herz is particularly interested in moving this forward.

7. Derivatives. "Offsetting Receivables or Liabilities Recognized upon Payment or Receipt of Cash Collateral in Master Netting Arrangements" would permit offsetting of receivables and liabilities associated with cash collateral, against the recorded amount of a net derivative position that is subject to a master netting arrangement. The FASB board agreed that the proposed FSP would apply for fiscal years beginning after Dec. 15, 2006.

8. Pensions. FAS 158, "Employers' Accounting for Defined Benefit Pension and other Postretirement Plans," was issued in 2006. The standard requires employers to recognize overfunded and underfunded status of a defined-benefit postretirement plan as an asset or liability.

While the effective date for public entities was the end of fiscal years ending after Dec. 15, 2006, non-public entities are required to adopt in the fiscal year ending after June 15, 2006 (but certain disclosures are still required in the notes to financial statements for a fiscal year ending after Dec. 15, 2006, but not before June 16, 2007). Companies also need to be aware of the dates of the actuarial information for '07 reporting.

9. Earnings per Share (joint). The FASB and International Accounting Standards Board (IASB) have reached differing conclusions on certain issues. FASB staff has analyzed those issues and expects to bring them to FASB's board in January 2007, enabling each board to issue due Exposure Drafts or final Statements (FASB-only) later this year.

10. Business Combinations. IASB and FASB are jointly working on a project regarding major changes to business combination accounting. The Exposure Draft on applying the acquisition method indicated a move more towards a "fair value" model.

Among the myriad of expected proposed major 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.

The boards continue to deliberate the issues, and a final standard is on the FASB's agenda for the second quarter of 2007. While this standard may not have reporting implications for 2007, it may set a tone for future reporting and measurement.