SF bulletin

By Stephen Barlas, Dallon Christensen, Christopher Dowsett

GOVERNMENT

Congress Casts Skeptical Eye at APB 23

By Stephen Barlas

One corporate accounting standard is likely to get considerable attention from Congress in the new session as tax reform takes center stage. Expect to start hearing louder complaints from both Democrats and Republicans about Accounting Principles Board Opinion No. 23 (APB 23), "Accounting for Income Taxes—Special Areas," established in the 1970s and essentially unchanged since then. It is codified in Accounting Standards Codification® (ASC) 740. The criticism has already started. At late-September hearings of the Permanent Subcommittee on Investigations, Sen. Carl Levin (D.-Mich.), who chairs the subcommittee, charged that U.S. corporations are using APB 23 as cover for refusing to repatriate foreign profits to the U.S. Lumping APB 23 in with other alleged "gimmicks," Levin said U.S. multinational corporations have stockpiled $1.7 trillion in earnings offshore. "It is not a pretty picture," he said. "It's unacceptable."

Lest anyone think that Levin, who will ascend to the chairmanship of the full committee in 2013, speaks only for Democrats, Sen. Tom Coburn (R.-Okla.), the second-ranked Republican on the committee, said Levin has identified "legitimate areas of concern." Coburn went on to say companies may not be purposely evading U.S. tax law, but they are engaging in "smart avoidance based on loopholes."

Coburn wondered whether APB 23 provides a gateway of sorts to that smart avoidance. APB 23 allows companies to not recognize future U.S. tax liability owed from foreign profits in their financial statements if the foreign undistributed earnings are invested "indefinitely." But APB 23 doesn't define "indefinitely," and it doesn't prescribe the specific elements of the reinvestment plan. A preparer must make judgments based on the entity's specific facts and circumstances to determine the appropriate accounting.

Coburn asked Susan Cosper, technical director for the Financial Accounting Standards Board (FASB), whether it was her testimony that "nothing needs to be changed" with regard to APB 23. Cooper started to give a boilerplate answer about how the FASB is always looking for ways to improve its standard. Coburn cut her off, repeating his question. Cosper then alluded to the FASB's

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short-term convergence process with the International Accounting Standards Board in 2004 that "looked at the area quite extensively." She said, "Users actually told us that to record a deferred tax liability when a company actually has no intention to pay the tax was more misleading." Coburn then asked what the FASB does if it finds out an auditor is "abusing or stretching" the standard through its recommendations to a company. Cosper essentially said that was up to the Public Company Accounting Oversight Board.

The committee invited executives from Hewlett-Packard (HP) to testify on its use of APB 23 as well as on issues related to loans from two offshore funds, which hold large amounts of unrepatriated cash, to the U.S. parent company. Lester Ezrati, senior vice president and tax director at HP, and Beth Carr, a tax partner at Ernst & Young LLP (E&Y), both

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remained cool and calm under Levin's very sharp questioning. Carr explained that HP, as disclosed in its financial statements for the year ended October 31, 2011, recognized an $8.2 billion liability related to approximately $25 billion of unremitted earnings of certain controlled foreign corporation subsidiaries (CFCs) that HP expects to repatriate to the U.S. HP has also disclosed that it intends to reinvest indefinitely outside of the United States approximately $29.1 billion of foreign earnings. Accordingly, no deferred tax liability has been accrued with respect to such earnings.

Carr acknowledged that the forward-looking and intent-based nature of the "indefinite" reinvestment assertion is, while not unique, somewhat unusual for an accounting standard. "It presents special challenges to an auditor, who must assess a client's intent and ability regarding future actions," she noted. E&Y's audit procedures include obtaining annual representations from the company's senior management, reviewing the company's history of maintaining its past assertions, considering past experience as to whether the company has operated in a manner consistent with previous representations, securing information regarding the company's plans for reinvestment, and considering the company's financial wherewithal or ability to maintain the assertion for the foreseeable future.

Ezrati talked about the input he provides to E&Y auditors about the company's dependence on APB 23. He said he consults with other HP executives, including the CFO, on what can be classified as "indefinitely reinvested." He explained, "I take into account prior years' history, working capital forecasts, long-term liquidity plans, capital improvement programs, merger and acquisition and other investment plans, U.S. cash needs, the expected business cycle, restrictions on distributions in certain countries, and country risk."

Errata

In the October 2012 Taxes column, the calculation for Example 2 was incorrect. The correct example is: "If Taxpayer A had wages of $220,000 (instead of $180,000) and net investment income of $30,000, the total additional HI tax would be $1,320. This amount is the sum of $180 (0.9% of ($220,000 - $200,000)) attributable to earned income and $1,140, which is the lesser of $1,140 (3.8% of $30,000) or $1,900 (3.8% of ($250,000 - $200,000)." Taxes editor Anthony Curatola would like to thank Ramon Fernandez, CMA, CPA, for catching the error.

Private Company Council Announces First Public Meeting

The Private Company Council (PCC) will hold its first public meeting on December 6, 2012, at the offices of the Financial Accounting Foundation (FAF) in Norwalk, Conn.

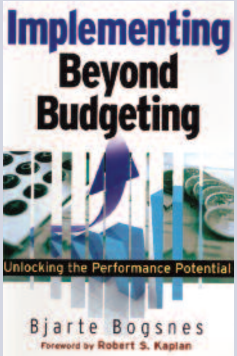
Items on the agenda include the official transition from the Private Company Financial Reporting Committee and a discussion of the Financial Accounting Standards Board's (FASB) *Private Company Decision-Making Framework*, including the feedback from those responding to the FASB's Invitation to Comment. There will also be a preliminary discussion of current FASB projects and standards relevant to private companies, and FASB staff will provide a briefing on private company issues and projects.

The PCC was formed to work with the FASB to help determine if and when changes should be made to U.S. Generally Accepted Accounting Principles (GAAP) for private companies. PCC Chairman Billy M. Atkinson said, "The 10 members of the PCC are eager to begin addressing the critical issues facing users, preparers, and auditors of private company financial statements. Our success will be based on collaboration and mutual respect for and between the PCC and the FASB, which I am confident we will achieve, and our ability to obtain meaningful feedback on all issues from private company stakeholders."

The meeting will be webcast live on the FAF website (www.accountingfoundation.org).

BOOKS

Breaking Free from Budgeting



"Bjarte, I expect the unexpected." With those words, Borealis CFO (and later CEO) Svein Rennemo charged Bjarte Bogsnes with finding a new way to grow Borealis in the challenging oil industry. In today's world of tight budgets and traditional cost control, Bogsnes set out to do just that through the use of Beyond Budgeting. His book, *Implementing Beyond Budgeting*, charts the course Bogsnes took to break free of the traditional budgeting process so many of us face in our jobs.

Even the most passionate finance professional likely views the word "budget" with some dread. Management wants budgets to control spending, monitor performance, and ensure alignment with company objectives, while finance professionals think of long nights, lengthy negotiations, and identifying "game playing" among operations. Bogsnes outlines a persuasive case for companies to eliminate the "command and control" concept of budgeting in exchange for a process of relative performance management, transparent comparison to internal divisions and external benchmarks, and rolling forecasting.

Bogsnes spends the first part of *Implementing Beyond Budgeting* outlining his argument for abolishing the traditional budget process. Many of us will sympathize with some of these points through our own experiences:

- Budgeting leads to unnecessary spending almost as much as it leads to cost control.
- Leadership and line management engage in "sandbagging" and other suboptimal behavior.
- Budgets drive target setting and resource allocation.

Throughout the book, Bogsnes draws heavily on his experience in two Beyond Budgeting implementations at the Scandinavian oil companies Borealis and Statoil. The case studies he includes provide compelling examples of how a properly developed Beyond Budgeting program can work. I learned the following three lessons from this book:

Set relative targets rather than absolute ones. Absolute budget targets can lead to a cost floor just as easily as a cost ceiling. The case studies highlight how companies compared key performance indicators (KPIs) among different operating divisions as well as to external benchmarks. The companies were able to maximize opportunities unexpectedly arising instead of saying, "That isn't in our budget." The KPIs were based on ratios, eliminating absolute dollar targets.

Disconnect resource allocation from target setting. Both resource allocation and target setting are important organizational objectives, but using the same system to set performance goals and allocate resources leads to game playing and other disruptive behaviors. Bogsnes writes about how good target setting must have an element of stretch and challenge to it. If the same process allocated resources and sets targets, the compromise will dilute the quality of both processes.

Forecasts must be designed to take action. Good forecasting will give management the information needed to take action on future activities. I design a five-quarter rolling forecast for my coaching clients, similar to what Bogsnes advocates in the book. The forecast is a realistic vision of the future based on our best information. These forecasts must also focus on higher-level KPIs instead of attempting to predict absolute numbers for sales and income.

The concepts Bogsnes discusses run counter to the current sentiments in today's business environment. There are some companies adopting pieces of the Beyond Budgeting framework, but there's still much work to be done. *Implementing Beyond Budgeting* is a great book to begin the discussion of how we can make planning and forecasting a tool for better business results instead of a compliance-based, check-the-box exercise that frustrates management and finance alike.—Dallon Christensen, CMA, CFM, CPA.CITP, dc@whiteboardbusiness.com