

Consumer Business Compass

Summer 2007

The Newsletter of the BDO Seidman
Retail and Consumer Product Practice

The Big Picture

Obstacles to U.S. Expansion, Quality of Suppliers Among Chief Retail Risk Factors



by Doug Hart
Partner, BDO Seidman Retail and Consumer Product Practice

The U.S. Consumer Product Safety Commission recently issued a recall notice for children's necklaces and earrings manufactured in China that were found to contain dangerously high levels of lead. The recall came amid a spate of moves by regulators to turn away or recall Chinese products ranging from automobile tires to food and toothpaste, citing potential safety and health risks.

These incidents corroborate research released last month by BDO Seidman, LLP indicating that over three quarters (81%) of U.S. retailers cite risks associated with suppliers in the U.S. and internationally, including product quality and safety issues, as a one of their leading concerns.

The report, **The 2007 BDO Seidman RiskFactor Report for Retail Businesses**, examined the risk factors listed in the most recent SEC filings of the largest 100 publicly traded U.S. retailers; the factors were analyzed and ranked by order of frequency cited. The retailers identify strong competition (91%) and general economic conditions (86%), such as the high fuel costs and weak housing market, as the most common risk factors. The vast majority (84%) of major retailers are concerned that adverse community reactions and market saturation is impeding their ability to expand in the United States. Also ranking high among retailer concerns is labor risk (56%) and changes in federal, state and local regulations (51%).

continues on page 2

Top 20 Risk Factors of the 100 Largest U.S. Retailers

1. Competition and Consolidation in Retail Sector	91%
2. General Economic Conditions	86%
3. Impediments to Further U.S. Expansion	84%
4. U.S. and Foreign Supplier/Vendor Concerns	81%
5. Labor (health coverage, union concerns)	56%
6. Changes to Federal, State or Local Regulations	51%
7. Implementation of IT Systems	50%
8. Dependency on Consumer Trends	49%
9. Indebtedness	44%
10. Natural Disasters/Terrorism	44%
11. Loss of Key Management/New Management	43%
12. Seasonal Flux in Sales	41%
13. Pending Mergers & Acquisitions	36%
14. Marketing Concerns	34%
15. Legal Proceedings	33%
16. Changes to Accounting Standards/Regulations	32%
17. Changes Specific to International Operations	27%
18. Privacy Concerns Related to Security Breach	26%
19. Balancing Inventory	22%
20. Product Liability	22%

SOURCE: *The 2007 BDO Seidman RiskFactor Report for Retail Businesses*



BDO Seidman, LLP
Accountants and Consultants

The Big Picture

Retail Risk Factors (continued from page 1)

BDO Seidman created **The 2007 BDO Seidman RiskFactor Report** to serve as an annual benchmark of the changing concerns of major public retailers and consumer product businesses. The initial study shows that market saturation and the “not-in-my-backyard” reaction from various communities has resulted in a major impediment to U.S. market expansion for large retailers. The research indicates that recent events dealing with data breaches and food safety issues have caused some alarm in the consumer product industry. In making these disclosures, management is communicating to shareholders that attention must be given to the resolution of these issues before they impact customer confidence and, consequently, sales.

Further findings in The 2007 BDO Seidman RiskFactor Report for Retail Businesses:

- **Labor Pains.** More than half (56%) of the top 100 public retailers cite labor concerns as an issue. Concerns with unions and the increasing pressure to provide health insurance were among the more frequently mentioned labor risks. Pension risks and high turnover were also cited.
- **Regulatory Reflux.** Half (51%) of the top 100 retailers declared that changes in federal, state and local regulations may impact their bottom line. Some reports specifically cited the new FIN 48 accounting rules that require businesses to report any uncertain tax positions in their financial statements. Retailers need to pay special attention to state and local tax, international tax, and accounting methods.
- **Overextended?** The easy access to capital over the past few years has created debt issues for businesses. Forty-four percent of the retailers in the study have concerns about their indebtedness, which they fear may impact their credit and financing capabilities in the coming year.
- **Management Turnover.** The highly competitive retail environment has led to high turnover among C-level executives and put high performing executives at a premium. In fact, the study showed that 43 percent of retailers noted that a loss of key management personnel, including CEOs and Directors of Boards, may impact their ability to meet earnings expectations.
- **Protecting Privacy.** As retailers collect more consumer data to further focus their targeted marketing efforts, they are becoming increasingly wary to rising risk in the area of privacy. Some well publicized security breaches (such as TJX) have driven this point home, as more than a quarter (26%) of the retailers cited privacy concerns as a risk factor. Further, within that grouping, some companies listed employee and corporate information leaks as a growing issue.

In an increasingly complex world, where issues ranging from globalization to emerging technologies bring both new benefits and new concerns, retail and consumer product businesses must deal with an ever-changing number of risk factors. The ability to manage these risks will play a key role in determining the winning businesses in the marketplace.

IRS Increases Scrutiny of Inventory Methodologies

Recently the Internal Revenue Service (IRS) issued a memorandum regarding temporary mark-downs under the lower of cost or market inventory methodology, which is causing some alarm as retail and consumer product businesses across the board begin to realize its implications.

Implications

The memo could result in companies having to: change the way temporary vs. permanent mark-downs are accounted for; alter their procedures regarding corporate discounts treated as mark-downs; revamp point-of-sale inventory methods; and possibly amend their accounting treatments of such items.

Specifically, it limits the ability of retailers using the retail method of accounting to estimate their mark-downs; thus companies must determine whether that discount is permanent or temporary. It also deems that corporate discounts offered only to special clientele are not considered to be mark-downs if the company follows the retail method of accounting.

Penalties

Failure to comply with the new IRS directive may lead to substantial penalties (possibly a percentage of the taxes owed by companies). In some cases this can be tens of millions of dollars.

Going Forward

Companies will need to analyze their “look forward” periods, reconcile their point-of-sale inventory methods and ensure their 10Ks reflect any possible issues. Problems could result in earning restatements and tax return amendments. As well, companies who have not already done so may want to consider filing a “method change” with the IRS.

For additional information on this topic, please contact Catherine Fox Simpson at cfox@bdo.com.

New SOX Guidance Issued For Public Companies

In advance of the five-year anniversary of the Sarbanes Oxley Act of 2002, both the SEC and the PCAOB recently released further guidance on internal control assessments for public companies.

Both the PCAOB and the SEC guidance embrace a principles-based approach to internal control assessments and should lead to greater clarity and efficiency for public consumer based businesses in their compliance with Sarbanes Oxley.

BDO Seidman Retail and Consumer Product Practice will be publishing a paper on the applicability of these standards to retail and consumer-based businesses including addressing the following issues:

- Applying a top-down approach
- Risk assessment
- Auditors reliance on the work of others, such as internal auditors
- IT benchmarking

Stay tuned.

Mark Your Calendars...

The following is a list of upcoming conferences and seminars of interest for retail and consumer product executives:

August 2007

- | | |
|---------------------|--|
| August 9 | ICSC 2007 Chicagoland Retail Connection
Hyatt Regency Chicago
Chicago, IL |
| August 12-14 | ICSC 2007 Florida Conference
Gaylord Palms Resort and Convention Center
Kissimmee, FL |

September 2007

- | | |
|------------------------|---|
| September 4-7 | 2007 U.S. RetailVision Conference
JW Marriott Desert Ridge Resort & Spa
Phoenix, AZ |
| September 10 | ICSC 2007 Commercial Real Estate and Capital Marketplace Conference
The Roosevelt Hotel
New York City, NY |
| September 17-18 | Shop.org Annual Summit 2007
Mandalay Bay Resort & Casino
Las Vegas, NV |
| September 18-20 | ICSC 2007 Western Division Conference
San Diego Convention Center
San Diego, CA |
| September 27-28 | Value Retail News Fall Outlet Retail Convention
Sheraton Meadowlands Hotel and Conference Center
East Rutherford, NJ |

Did You Know...

According to **STORES** magazine, on average 9 percent of all sales across the U.S. retail industry result in merchandise returns...

The National Retail Security Survey, conducted by the NRF, found that retailers lose 1.61% of store sales to theft and fraud...

Shop.org estimates that online sales of jewelry are expected to hit \$5.2 billion this year...

BDO Seidman Retail & Consumer Product Practice

BDO Seidman, LLP has been a valued business advisor to retail and consumer product companies for almost 100 years. The firm works with a wide variety of retail clients, ranging from multinational Fortune 500 corporations to more entrepreneurial businesses, on myriad accounting, tax and other financial issues.

For more information on BDO Seidman's service offerings to this industry vertical, please contact one of the regional service leaders below:

Al Ferrara, New York
aferrara@bdo.com / 212-885-8000

Steve Ferrara, Chicago
sferrara@bdo.com / 312-856-9100

Ted Vaughan, Dallas
tvaughan@bdo.com / 214-969-7007

Douglas Hart, San Francisco
dhart@bdo.com / 415-397-7900

Material discussed is meant to provide general information and should not be acted upon without first obtaining professional advice appropriately tailored to your individual circumstances.

To ensure compliance with Treasury Department regulations, we wish to inform you that any tax advice that may be contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding tax-related penalties under the Internal Revenue Code or applicable state or local tax or (ii) promoting, marketing or recommending to another party any tax-related tax-related penalties under the Internal Revenue Code or applicable state or local tax law provisions or (ii) promoting, marketing or recommending to another party any tax-related matters addressed herein.