



FEI's Top 10 Financial Reporting Issues for 2005

Deloitte & Touche Resources for Addressing These Issues

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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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Financial Executive International's (FEI's) chief executive officer and president, Colleen Cunningham, recently compiled a list of 10 prominent financial reporting challenges requiring the attention of financial executives in 2005, as reported in the January/February 2005 issue of *Financial Executive* magazine. To assist financial executives and audit committees in addressing these issues, Deloitte & Touche LLP (Deloitte & Touche) has prepared this summary, which includes Deloitte & Touche and other resources relevant to each topic.

1. Stock Options

Issue Identified by FEI: The Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 123 (Revised 2004), *Share-Based Payments*, in December 2004, requiring compensation costs associated with share-based payment transactions to be recognized in the financial statements. Companies should continue to monitor current developments related to the FASB's stock option project.

Deloitte & Touche Resource:

- *Heads Up: Vol. 11, Issue 10, 1•2•3(R)eady, Set, Go; Fair Value Accounting for Stock Options!* summarizes the issues addressed in the revised standard. The document is available on Audit Committee Online at www.auditcommittee.com/USEng/topics/contentItem.asp?topic=37&subject=159.

2. Internal Controls

Issue Identified by FEI: The provisions of Section 404 of the Sarbanes-Oxley Act are now effective for public companies that are accelerated filers with fiscal years ending after November 15, 2004. In 2006, all other Securities and Exchange Commission (SEC) filers will be subject to these provisions.

Deloitte & Touche and Other Resources:

- *Highlights of the PCAOB Auditing Standard No. 2: An Audit of Internal Control over Financial Reporting Performed in Conjunction with an Audit of*

Audit • Tax • Consulting • Financial Advisory.

Financial Statements is a special edition of the *Audit Committee Brief* that provides a high-level summary of key components of the auditing standard adopted by the Public Company Accounting Oversight Board (PCAOB). The document is available at www.auditcommittee.com/USEng/topics/contentItem.asp?topic=3&subject=15&ci=385.

- *Under Control: Sustaining Compliance with Sarbanes-Oxley in Year Two and Beyond* provides a straightforward discussion of the essential characteristics of sustainability, as well as a plain-English framework for deriving long-term value from internal control programs. The document explains key concepts, provides practical advice, and analyzes critical shortcomings that many companies experienced in their first-year efforts. The publication also outlines Deloitte & Touche's sustained compliance solution framework, a comprehensive approach to long-term sustainability. *Under Control: Sustaining Compliance with Sarbanes-Oxley in Year Two and Beyond* is available at www.auditcommittee.com/USEng/topics/contentItem.asp?topic=7&subject=24&ci=61.
- *Sarbanes-Oxley Section 404: 10 Threats to Compliance* identifies 10 key internal control issues that many companies find especially challenging to address. This paper, which can help companies take a proactive approach to these issues and keep Section 404 compliance work on track, is available at www.auditcommittee.com/USEng/topics/contentItem.asp?topic=3&subject=15&ci=76.
- *Perspectives on Internal Control Reporting: A Resource for Financial Market Participants* was developed by Deloitte & Touche, Ernst & Young LLP, KPMG LLP, and PricewaterhouseCoopers LLP to help financial market participants understand issues related to the new internal control reports. It is available at www.auditcommittee.com/USEng/topics/contentItem.asp?topic=3&subject=185.
- *Internal Control over Financial Reporting: An Investor Resource: Understanding Sarbanes-Oxley's Importance to Investing* was developed by Deloitte & Touche, Ernst & Young LLP, KPMG LLP, and PricewaterhouseCoopers LLP to help investors understand the nuances and purpose of the Sarbanes-Oxley Act. It can be accessed at www.auditcommittee.com/USEng/topics/contentItem.asp?topic=3&subject=185.
- *Sarbanes-Oxley: A Bridge to Excellence, Our Point of View* – This document sets forth Deloitte & Touche's view of Sarbanes-Oxley compliance. Corporate leaders who embrace the spirit of the law—strong ethics, good governance, and reliable reporting—can re-energize their companies and reassure investors. The document is available at www.auditcommittee.com/USEng/topics/contentItem.asp?topic=7&subject=24&ci=61.

- *A Capital Idea: Why It Just Might Make Sense to Do More Than Sarbanes-Oxley Mandates; Straight Talk Series, Book No. 5* – Sarbanes-Oxley offers companies an opportunity to leverage internal control investments to build a better business. By focusing on strong ethics, good governance, and reliable reporting, executives can use their readiness projects to identify ways to improve broader business processes and performance, ultimately increasing shareholder value. This document is available at www.auditcommittee.com/USEng/topics/contentItem.asp?topic=3&subject=15&ci=76.

- *A Framework for Evaluating Control Exceptions and Deficiencies* – Developed by representatives of nine public accounting firms, including Deloitte & Touche, and a professor at Georgia State University, this paper outlines a framework for assessing exceptions and deficiencies resulting from the evaluation of a company's internal control over financial reporting. The framework covers individual exceptions and deficiencies in process/transaction-level controls, information technology controls, and other pervasive controls. It also addresses the evaluation of deficiencies in the aggregate.

The publication sets forth views on a methodology consistent with PCAOB Auditing Standard No. 2, *An Audit of Internal Control over Financial Reporting Performed in Conjunction with an Audit of Financial Statements*. Although the framework is not a substitute for PCAOB Auditing Standard No. 2 and other relevant professional literature, the guidance set forth can help both auditors and issuers in evaluating internal control exceptions and deficiencies in a consistent manner. More information on this framework is available at www.auditcommittee.com/USEng/topics/contentItem.asp?topic=3&subject=170.

3. Revenue Recognition

Issue Identified by FEI: Companies should continue to monitor the FASB's current projects on revenue recognition and get involved in the deliberation process accompanying any related exposure drafts presented for public comment. The FASB is expected to issue a preliminary views document in the fourth quarter of 2005.

Deloitte & Touche and Other Resources:

- *Heads Up: Vol. 11, Issue 9, Do You Hear What I Hear? Accounting Highlights of the AICPA's December 6–8, 2004, SEC & PCAOB Conference* – This edition of *Heads Up* highlights the annual AICPA conference, which featured speeches by, and question-and-answer sessions with, members of the SEC, the PCAOB, and other standard-setters. The speech presented by G. Anthony Lopez, associate chief accountant in the SEC's Office of the Chief Accountant, specifically addresses the topic of

revenue recognition. The publication can be accessed at www.auditcommittee.com/USEng/topics/contentItem.asp?topic=37&subject=159.

- On December 17, 2003, the SEC issued Staff Accounting Bulletin (SAB) No. 104, which codified the notion of multiple-element arrangements into the SEC staff's Topic 13 on revenue recognition. SAB 104 also deleted from Topic 13 the discussion on gross versus net presentation in the financial statements, which is addressed by Emerging Issues Task Force (EITF) Issue 99-19. Finally, SAB 104 deleted SAB 101's "Frequently Asked Questions," incorporating many of those questions into Topic 13. The document is available at www.sec.gov/interp/account/sab104rev.pdf.

4. Uncertain Tax Positions

Issue Identified by FEI: The FASB is expected to issue an exposure draft and final statement on uncertain tax positions in the first part of 2005. The new statement will clarify the guidelines for recording tax benefits in the financial statements.

Deloitte & Touche and Other Resources:

- *Heads Up: Vol. 11, Issue 9, Do You Hear What I Hear? Accounting Highlights of the AICPA's December 6–8, 2004, SEC & PCAOB Conference* – This edition of *Heads Up* highlights the annual AICPA conference. The speech presented by Jane D. Poulin, associate chief accountant in the SEC's Office of the Chief Accountant, highlights some of the issues surrounding the accounting for tax benefits associated with uncertain tax positions. *Heads Up* can be accessed at www.auditcommittee.com/USEng/topics/contentItem.asp?topic=37&subject=159.
- *Financial Accounting Standards Board: Minutes of the February 16, 2005, Board Meeting* – The alternative approaches to accounting for "uncertain tax positions and transition method alternatives for the proposed interpretation" were discussed at the February 16, 2005, meeting of the FASB. The minutes of that meeting can be accessed through the FASB's Web site at www.fasb.org/board_meeting_minutes/02-16-05_utp_rev.pdf, and the ongoing project update information is available at www.fasb.org/project/uncertain_tax_positions.shtml.

5. Unremitted Foreign Earnings

Issue Identified by FEI: As a result of the American Jobs Creation Act of 2004, U.S. companies are allowed a special, limited-time deduction of 85 percent of dividends received upon the repatriation of certain foreign subsidiary earnings. Companies are required to record the income tax effect based on the planned earnings to be repatriated.

Deloitte & Touche and Other Resources:

- *The American Jobs Creation Act of 2004: An Overview of Domestic and International Provisions* – This overview, prepared by the Tax Policy Services Group of Deloitte Tax LLP, will help companies understand the new bill's scope as well as what will be required for compliance, tax planning, risk management, and controls and processes. The document can be accessed at www.auditcommittee.com/USEng/topics/contentItem.asp?topic=2&subject=186.
- *Heads Up: Vol. 11, Issue 7, Bringing Home the Bacon! New Tax Act Stimulates Repatriation of Earnings, Offers Tax Breaks to U.S. Manufacturers* – This issue of *Heads Up* summarizes the key financial reporting implications of the American Jobs Creation Act of 2004, which provides for \$137 billion in tax cuts over the next 10 years. These are mainly targeted at U.S. manufacturers and multinational companies. This edition of *Heads Up* can be accessed at www.auditcommittee.com/USEng/topics/contentItem.asp?topic=37&subject=159.
- *Compensation Provisions in the American Jobs Creation Act of 2004: Changing the Landscape of the Design of Executive Compensation* – The American Jobs Creation Act of 2004 changed the environment for executive compensation, providing dramatic changes in the tax rules applicable to nonqualified deferred compensation. Coupled with expected revisions in accounting for equity compensation and increased shareholder and IRS scrutiny of compensation provided to top officers, these changes will affect how most companies pay their executives. The legislation also requires companies to revise their compensation tracking and payroll systems to comply with new reporting and withholding requirements. Other changes will affect the taxation of employees of multinational companies who work outside their home countries. The document can be accessed at www.auditcommittee.com/USEng/topics/contentItem.asp?topic=2&subject=186.
- *Heads Up: Vol. 11, Issue 8, Well, Isn't That Special? FASB Staff Proposes Accounting Guidance in Response to the New Tax Act* – This issue of *Heads Up* summarizes the proposed FASB staff positions on the American Jobs Creation Act of 2004, specifically addressing the deduction it offers to domestic manufacturers and the temporary lower tax rate on repatriated foreign earnings. This edition of *Heads Up* is available at www.auditcommittee.com/USEng/topics/contentItem.asp?topic=37&subject=159.
- For additional information on the American Jobs Creation Act of 2004, refer to our *Accounting Roundup 4th Quarter in Review* publication at www.auditcommittee.com/USEng/topics/contentItem.asp?topic=37&subject=158.

6. Business Combinations

Issue Identified by FEI: The FASB is expected to issue an exposure draft in the second quarter of 2005 that will result in sweeping changes to the rules affecting business combinations. A joint task force from the FASB and the International Accounting Standards Board (IASB) is involved in moving the accounting for business combinations to a more fair-value-based model. A final statement is expected in the fourth quarter of 2005.

Deloitte & Touche Resource:

- *Heads Up: Vol. 11, Issue 9, Do You Hear What I Hear? Accounting Highlights of the AICPA's December 6–8, 2004 SEC & PCAOB Conference* – This edition of *Heads Up* highlights the annual AICPA conference. The speech presented by Russell P. Hodge, professional accounting fellow in the SEC's Office of the Chief Accountant, specifically addresses business combinations. The publication can be accessed at www.auditcommittee.com/USEng/topics/contentItem.asp?topic=37&subject=159.

7. Inventory Costs

Issue Identified by FEI: In late 2004, the FASB issued SFAS No. 151, *Inventory Costs*, which is effective for fiscal years ending after June 15, 2005. The new statement is an amendment of Accounting Research Bulletin No. 43, Chapter 4, and clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs, and spoilage.

Deloitte & Touche Resource:

- For a high-level summary of SFAS No. 151, *Inventory Costs*, refer to *Accounting Roundup 4th Quarter in Review* at www.auditcommittee.com/USEng/topics/contentItem.asp?topic=37&subject=158.

8. Off-Balance-Sheet Arrangements Disclosures

Issue Identified by FEI: Companies should continue to monitor issues related to the accounting for, and disclosure of, off-balance-sheet items. The SEC is expected to issue its report on off-balance-sheet items in the early part of 2005.

Deloitte & Touche Resource:

- *SEC Interpretation: Commission Guidance Regarding Management's Discussion and Analysis (MD&A) of Financial Condition and Results of Operations* provides interpretations of the SEC's MD&A guidance. This Deloitte & Touche document is available at www.auditcommittee.com/USEng/topics/contentItem.asp?topic=2&subject=14.

9. XBRL

Issue Identified by FEI: The SEC requested that companies begin to voluntarily report in eXtensible Business Reporting Language (XBRL) in 2004. The SEC and FASB are adding staff dedicated to the management and facilitation of the XBRL conversion process. XBRL permits text-based data (such as EDGAR filings) to be electronically tagged or identified, facilitating the automated retrieval, analysis, and exchange of the selected data. For example, net income would have a unique tag that would allow users to pull that information from filings for quick, easy comparison and analysis. Companies are expected to migrate to XBRL throughout 2005. For more information on XBRL, including its origin, purposes, and uses, please refer to www.xbrl.org.

Deloitte & Touche and Other Resources:

- *Heads Up: Vol. 11, Issue 9, Do You Hear What I Hear? Accounting Highlights of the AICPA's December 6–8, 2004, SEC & PCAOB Conference* – This edition of *Heads Up* highlights the annual AICPA conference. Don Nicolaisen, chief accountant in the SEC's Office of the Chief Accountant, commented on the migration to XBRL. A summary of his comments can be found at www.auditcommittee.com/USEng/topics/contentItem.asp?topic=37&subject=159.
- The full text of Don Nicolaisen's speech has been posted to the SEC's Web site at www.sec.gov/news/speech/spch120604dtn.htm.

10. MD&A Guidance

Issue Identified by FEI: The SEC continues to call for greater transparency in financial statements. One area of focus is critical corporate accounting policies. The policies included in the financial statements should provide users with enough information to reach an adequate understanding of the company's business model.

Deloitte & Touche Resources:

- *SEC Interpretation: Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations* summarizes certain significant concepts included in the SEC's guidance. This document is available at www.auditcommittee.com/USEng/topics/contentItem.asp?topic=2&subject=14.
- *Heads Up: Vol. 11, Issue 9, Do You Hear What I Hear? Accounting Highlights of the AICPA's December 6–8, 2004, SEC & PCAOB Conference* – This edition of *Heads Up* features a speech by Scott A. Taub, deputy chief accountant of the SEC's Office of the Chief Accountant. The speech specifically addresses the topic of improving financial reporting. *Heads Up* can be accessed at www.auditcommittee.com/USEng/topics/contentItem.asp?topic=37&subject=159.

General Resources:

Audit Committee Brief

Audit Committee Brief is a Deloitte & Touche quarterly publication for audit committee members that provides best practices, an overview of corporate governance resources, a look at the regulatory and legislative environment, and other relevant information for audit committee members. *Audit Committee Briefs* are available at www.auditcommittee.com/USEng/topics/contentItem.asp?topic=37&subject=157.

Accounting Roundup

Deloitte & Touche's *Accounting Roundup* newsletter summarizes the latest accounting regulations, SEC rules, and legislative activity to help accounting professionals prepare financial statements. *Accounting Roundup* is available at www.auditcommittee.com/USEng/topics/contentItem.asp?topic=37&subject=158.

EITF Roundup

EITF Roundup is a Deloitte & Touche newsletter that provides an overview of issues, consensuses, and administrative matters at meetings of the Emerging Issues Task Force. *EITF Roundup*, which is published after each meeting, is available at www.auditcommittee.com/USEng/topics/contentItem.asp?topic=37&subject=165.

DART

Literature from the FASB, EITF, SEC, PCAOB, IASB, and AICPA and current versions of our interpretive guidance are available through the Deloitte Accounting Research Tool (DART). DART is a comprehensive online library of accounting and financial disclosure literature. Available as a subscription service, DART provides users with access to this information any time, from any computer. For more information and to view a demonstration, refer to www.deloitte.com/us/dart.

World Tax Advisor, U.S. Tax News and Views, and IRS Insights

To stay informed on tax developments around the globe, consult the publications from the member firms of Deloitte Touche Tohmatsu. Important tax changes are highlighted and their implications for businesses or individuals are analyzed. To subscribe to any of these tax publications, visit www.deloitte.com.

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