



US Reporting Newsletter for Non-US Based Companies

Global Offerings Services

November-December 2004

Global Offerings Services (GOs) comprises a global team of practitioners assisting non-US companies and non-US practice office engagement teams in applying US and International accounting standards (i.e., US GAAP and IFRS) and in complying with the SEC's financial reporting rules. For more information please contact the GOs Center leader nearest you.

New York – Joel Osnoss
+1 (212) 436 3352

Hong Kong – Jay Harrison
+852 2852 6337

London - Donna Ward
+44 (20) 7007 0902

Madrid – Manuel Arranz
+34 (91) 514 5072

Mexico City – James Primus
+52 (55) 5080 6784

Paris – Don Andrade
+33 (1) 4088 2508

Sao Paulo – Ed Ruiz
+55 (11) 5185 2500

Tokyo – Paul Thurston
+81 (3) 6213 3159

Toronto - Rod Barr
+1 (416) 874 3630

Deloitte periodically publishes Accounting Roundups and Heads Ups. [Click here](#) to access the published ones.

GAAP Matters

FASB Issues a New Standard, FASB Statement No. 151 on Inventory Costs

On November 24, 2004, the Financial Accounting Standards Board (FASB) issued FASB Statement No. 151, *Inventory Costs, an amendment of ARB No. 43, Chapter 4* (Statement 151). The amendments made by Statement 151 clarify that “abnormal” amounts of idle facility expense, freight, handling costs, and wasted materials (spoilage) should be recognized as current-period charges require the allocation of fixed production overheads to inventory based on the normal capacity of the production facilities. Statement 151 is the result of a broader effort by the FASB to improve the comparability of cross-border financial reporting by working with the International Accounting Standards Board (IASB) toward development of a single set of high-quality accounting standards. The FASB and the IASB noted that ARB 43, Chapter 4 and IAS 2, *Inventories*, are both based on the principle that the primary basis of accounting for inventory is cost. Both of those accounting standards also require that “abnormal” amounts of idle freight, handling costs, and wasted materials be recognized as period costs; however, the Boards noted that differences in the wording of the two standards could have led to the inconsistent application of those similar requirements. The FASB concluded that clarifying the existing requirements in ARB 43 by adopting language similar to that used in IAS 2 is consistent with its goals of improving financial reporting in the United States and promoting convergence of accounting standards internationally. The guidance is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. Earlier application is permitted for inventory costs incurred during fiscal years beginning after November 23, 2004. The provisions of Statement 151 should be applied prospectively. [Click here](#) to access the full text of the Statement.

Additional New Standards issued by FASB

On December 16, 2004, the FASB published three additional new standards - FASB Statement No. 123 (R), *Share-Based Payment*, Statement No. 152, *Accounting for Real Estate Time-Sharing Transactions*, and Statement No. 153, *Exchanges of Nonmonetary Assets, an amendment of APB Opinion No. 29, Accounting for Nonmonetary Transactions*. These standards will be covered in the January issue of the GOs newsletter. [Click here](#) to access these standards on the FASB website.

Recent Emerging Issues Task Force (EITF) Meeting

The EITF met on November 17 – 18, 2004 and reached consensus on Issue No. 03-13, *Applying the Conditions in Paragraph 42 of FASB Statement No. 144, Accounting for the Impairment or Disposal of Long-*

Lived Assets, in Determining Whether to Report Discontinued Operations:

This EITF consensus was ratified by the Financial Accounting Standards Board (FASB) at its November 30, 2004 meeting.

The Task Force also discussed the following issues without reaching a consensus:

- Issue No. 04-5, *Investor's Accounting for an Investment in a Limited Partnership When the Investor Is the Sole General Partner and the Limited Partners Have Certain Rights*
- Issue No. 04-6, *Accounting for Post-Production Stripping Costs in the Mining Industry*
- Issue No. 04-7, *Determining Whether an Interest Is a Variable Interest in a Variable Interest Entity*
- Issue No. 04-11, *Accounting in a Business Combination for Deferred Postcontract Customer Support Revenue of a Software Vendor*
- Issue No. 04-12, *Determining whether Equity Based Compensation Awards Are Participating Securities*
- Issue No. 04-13, *Accounting for Purchases and Sales of Inventory with the Same Counterparty*

The Task Force removed from the agenda Issue No. 04-11, [Accounting in a Business Combination for Deferred Postcontract Customer Support Revenue of a Software Vendor], and noted that the FASB may be addressing this issue in its Fair Value Measurement project, Phase Two of Business Combinations, or its project on Revenue Recognition. In addition, the Task Force removed from the agenda Issue 04-12, [Determining whether Equity Based Compensation Awards Are Participating Securities], and recommended that the FASB issue a Board-directed FASB Staff Position (FSP).

At its November 30, 2004 meeting, the Task Force also agreed to change the effective dates in Issue No. 04-8, *The Effect of Contingently Convertible Instruments on Diluted Earnings per Share*, and in Issue No. 04-10, *Determining Whether to Aggregate Operating Segments That Do Not Meet the Quantitative Thresholds*. Specifically, Issue 04-8 will be effective for reporting periods ending after December 15, 2004, and the effective date of Issue 04-10 was deferred to coincide with a pending FSP that will provide guidance in determining whether two or more operating segments have similar economic characteristics. The FASB staff does not anticipate final issuance of the pending FSP until March 2005 with a likely effective date of fiscal periods ending after March 15, 2005.

[Click here](#) for the full text of the November EITF roundup and [click here](#) for the full text of the minutes of the EITF meeting.

Consensus on EITF Issue No. 03-13, "Applying the Conditions in Paragraph 42 of FASB Statement No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, in Determining Whether to Report Discontinued Operations"

Statement 144 indicates that the Board intended the standard to expand the number of entities reporting discontinued operations compared to its predecessor, APB Opinion No. 30, *Reporting the Results of Operations — Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*. Ironically, paragraph 42 of Statement 144 contravenes this goal by including the following requirements to Statement 144:

"(a) the operations and cash flows of the component have been (or will be) **eliminated** from the ongoing operations of the entity as a result of the disposal transaction and (b) the entity will not have any **significant continuing involvement** in the operations of the component after the disposal transaction."
[Emphasis added]

Requirement (a) often has been narrowly interpreted (i.e., **any** and **all** cash flows must be eliminated). In essence, Issue 03-13 deals with questions raised by the apparent contradiction between the actual words of paragraph 42 and the Board's intention to expand the use of discontinued operations reporting.

The specific issues addressed are:

- Which cash flows of the discontinued component should be considered in the determination of paragraph 42(a), and
- What types of continuing involvement constitute significant continuing involvement under paragraph 42(b)?

Issue 03-13 also addresses the appropriate (re)assessment period for determining whether the conditions for discontinued operations reporting are met under paragraph 42.

The Task Force reached a consensus that classification of a disposed component as a discontinued operation is appropriate only if the ongoing entity:

- Step 1:** Has no **continuing direct cash flows** (a term Issue 03-13 introduces to interpret paragraph 42(a)), and
- Step 2:** Does not retain an interest, contract, or other arrangement sufficient to enable it to exert significant influence over the disposed component's operating and financial policies after the disposal transaction (an interpretation of paragraph 42(b)).

Issue 03-13 should be applied to components that are disposed of or classified as held for sale in periods beginning after December 15, 2004. Previously reported operating results within an enterprise's fiscal year that includes the ratification date may be reclassified to reflect the consensus. [Read more](#) on this issue below.

EITF Issue 03-1 on Other-Than-Temporary Impairments Delayed

FASB staff has confirmed informally that the recognition provisions of EITF Issue No. 03-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments* (Issue 03-1), will not be effective in 2004. Earlier this fall, FASB postponed the effective date for the issue's recognition provisions (see FSP EITF Issue 03-1-1, "Effective Date of Paragraphs 10-20 of EITF Issue No. 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments") until the FASB resolved certain implementation issues regarding the consensus.

FASB's proposed implementation guidance is contained in a draft FSP EITF Issue 03-1-a, *Implementation Guidance for the Application of Paragraph 16 of EITF Issue No. 03-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*. To date, FASB has received over 200 comment letters on the draft, generally critical of the Board's proposal and the original consensus decision. The staff is in the process of analyzing the comment letters.

Also, it is possible that the Board will consider other-than-temporary impairment and related topics in a broader agenda project, obviating the need to resolve Issue 03-1. A broader project might question whether the available-for-sale classification continues to meet the needs of users of financial statements, or whether an impairment analysis should include a positive assessment of management's intent and ability.

The current sources of GAAP continue to apply to the accounting for other-than-temporary impairments, including

- FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*
- SEC Staff Accounting Bulletin Topic 5.M, "Other Than Temporary Impairment of Certain Investments in Debt and Equity Securities"
- FASB Staff Implementation Guide (Statement 115), "A Guide to Implementation of Statement 115 on Accounting for Certain Investments in Debt and Equity Securities: Questions and Answers"
- EITF Issue No. 99-20, "Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets"
- AICPA Statement on Auditing Standards No. 92, *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities*

The above literature also includes guidance regarding an investor's intent and ability to hold impaired securities. [Click here](#) for the full text of the FASB announcement.

AICPA Issues Audit Risk Alerts – Interpretive Guidance Available

Starting on November 5, 2004, the American Institute of Certified Public Accountants (AICPA) issued the following Audit Risk Alerts, which provide an overview of recent economic, industry, regulatory, and professional developments affecting the specified industries:

- [Real Estate Industry Developments – 2004/2005](#)
- [Bank, Credit Union, and Other Depository and Lending Institution Industry Developments – 2004/2005](#)
- [Manufacturing 2004/2005](#)
- [Securities Industry Developments 2004/2005](#)
- [High-Technology Enterprises 2004/2005](#)
- [Investment Companies Industry Developments 2004/2005](#)
- [Construction Contractors Industry Developments – 2004/2005](#)
- [Insurance Companies Industry Developments 2004/2005](#)

These Audit Risk Alerts may be useful in gaining an understanding of how current accounting, auditing, and regulatory developments affect the specified industries.

In addition to the above industry specific alerts, the AICPA has also issued the following Audit Risk Alerts:

- [Compilation and Review Alert – 2004/2005](#)
- [Independence and Ethics Alert – 2004/2005](#)
- [General Alert – Strengthening Audit Integrity, Safeguarding Financial Reporting – 2004/2005](#)

The Compilation and Review Alert provides clarifying guidance of Statements on Standards for Accounting and Review Services (SSARS) No. 10, *Performance of Review Engagements*, and No. 11, *Standards for Accounting and Review Services*. In addition, the Independence and Ethics Audit Risk Alert provides interpretive guidance of the independence requirements under the AICPA Code of Professional Conduct and, if applicable, certain other rule-making and standard-setting bodies (e.g., SEC, PCAOB and the GAO). Contingent fees in tax matters are addressed in this Alert as well. The General Alert will help to plan and perform audits by identifying the significant business risks that may result in the material misstatement of your client's financial statements. Click on the alert to purchase it online.

Accounting Highlights of the AICPA's December 6-8, 2004 SEC & PCAOB Conference

Every year during the holiday season, the AICPA hosts a conference featuring speeches by, and question and answer sessions with, members of the SEC, the PCAOB, and other standard-setters. While the speakers rightfully indicate that their remarks do not necessarily reflect the views of their organizations, the remarks clearly provide insight into current concerns and priorities.

This year's recurring theme? Regulators, preparers and auditors have worked hard, making progress toward the goal of ending accounting, internal control and auditing failures that have so sapped investor trust and confidence. Nevertheless, much remains to be done. According to Donald T. Nicolaisen, the SEC's Chief Accountant:

"Investors continue to be skeptical of management and auditor reports, and this prolonged erosion in investor confidence remains troubling. Investors and the public rightly demand more...I believe there is still much we can do."

The conference also provides a forum for regulators to share information and to express a variety of other concerns in advance of the annual reporting season. Topics ranged widely, covering matters such as:

- PCAOB's new auditing standards, audit firm inspection matters, and internal control reporting requirements;
- Convergence of U.S. and International accounting standards;
- SEC filing rules;
- Corporate governance and fraud; and
- AICPA's Centers for Public Company Audit Firms and Corporate Governance.

Deloitte & Touche LLP issued a Heads Up, which focuses only on those speeches (or other comments) that deal with financial accounting and reporting in accordance with U.S. generally accepted accounting principles. Further, topics that cover information that is already widely available from other sources were omitted.

The Heads Up includes a summary of speeches and other comments organized by speaker and topic. [Click here](#) to access the full text of the Heads Up.

American Jobs Creation Act of 2004

On October 22, 2004, the President of the United States signed into law the American Jobs Creation Act of 2004 (the Act). As the first major broad-based restructuring of business taxes since 1986, the Act contains \$137 billion in tax cuts over the next ten years including the following:

1. Tax relief for U.S.-based manufacturing activities (\$77 billion).
2. Tax reform of multinational businesses (\$43 billion).
3. Four dozen more targeted items of business income tax relief (\$10 billion).
4. Targeted individual tax cuts and excise tax reforms (\$7 billion).

The FASB staff has provided accounting guidance for certain of the Act's provisions by issuing two FASB Staff Positions (FSPs), FSP FAS 109-a, *Application of FASB Statement No. 109, Accounting for Income Taxes, for the Tax Deduction Provided to U.S. Based Manufacturers by the American Jobs Creation Act of 2004*, and FSP FAS 109-b, *Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision Within the American Jobs Creation Act of 2004*, dealing with the following:

- The deduction the Act offers to domestic manufacturers, and
- The temporary lower tax rate on repatriated foreign earnings

Both FSPs were finalized on December 21, 2004 and are effective immediately upon issuance. [Click here](#) for the discussion of FSPs in the Accounting Roundup, [click here](#) to access the full text of FSPs. In addition, Deloitte & Touche LLP issued two issues of Heads Up. [Issue 7](#) focuses on key financial reporting implications of the Act and the areas of the Act that need to be considered right away. [Issue 8](#)

discusses the manufacturing deduction and repatriation of foreign earnings in more detail.

SEC and Other Regulatory Matters

SEC Postpones Filing Date for Internal Control Reports for Some Accelerated Filers

On November 30, 2004, the U.S. Securities and Exchange Commission (SEC) issued an exemptive order to grant certain accelerated filers up to an additional 45 days to include in their annual reports management's report on internal control over financial reporting and the related auditor's report on management's assessment of internal control over financial reporting. Both internal control reports are required under Commission rules implementing Section 404 of the Sarbanes-Oxley Act of 2002. All other information required in annual reports, including audited financial statements, would have to be filed on the original due date for the annual reports.

The postponement came about due to the SEC's concern about the resource constraints at accounting firms and at smaller public companies, and to encourage companies to file important information for investors, including audited financial statements, on a timely basis, while providing an appropriate accommodation for internal control reports.

The exemptive order applies to an accelerated filer that has a fiscal year ending between and including November 15, 2004 and February 28, 2005, and that had a public equity float of less than \$700 million at the end of its second fiscal quarter in 2004. Commission rules define an "accelerated filer" as a company that

- has a public float of at least \$75 million;
- has been subject to the SEC's periodic reporting requirements for at least 12 months and has filed one annual report; and
- is not eligible to use the SEC's small business reporting forms.

[Click here](#) for full text of the exemptive order.

PCAOB Adopts Temporary Transition Rule To Facilitate The Objectives Of The SEC's Exemptive Order To Postpone The Filing Date For Internal Control Reports For Some Accelerated Filers

On November 30, 2004, the Public Company Accounting Oversight Board (PCAOB) adopted a temporary transitional rule relating to PCAOB Auditing Standard No. 2, *An Audit of Internal Control over Financial Reporting Performed in Conjunction with an Audit of Financial Statements*. The temporary rule facilitates the objectives of the SEC's exemptive order, also issued on November 30, 2004, to grant certain accelerated filers up to an additional 45 days to include in their annual reports management's report on internal control over financial reporting and the related auditor's report on management's assessment of internal control over financial reporting.

The temporary rule would (1) permit auditors to date their reports on management's assessment of the effectiveness of internal control over financial reporting later than the date of their reports on the financial statements, and (2) waive the provision for the auditor's separate report on the financial statements to include a paragraph that refers to a separate report on internal control over financial reporting in connection with their audits of companies relying on the SEC's exemptive order.

The temporary rule has been submitted to the SEC for approval, as required by the Sarbanes-Oxley Act of 2002. If approved, the temporary rule will take effect immediately. By the rule's terms, it will expire on July 15, 2005. [Click here](#) to access the full text of the Rule.

SEC Proposes Securities Offering Reform

On October 26, 2004, the SEC voted to propose modifications to the registration, communications, and offering processes under the Securities Act of 1933. The proposals would address communications related to registered securities offerings, delivery of information to investors, and registration and other procedures in the offering and capital formation process. Among other changes, the proposals would:

- Allow electronic delivery and Internet access to offering documents in lieu of physical prospectus delivery,
- Streamline the shelf registration process for "Well-Known Seasoned Issuers," a newly defined category of issuer,
- Encourage issuers to make more information available during the offering period, and
- Focus issuers and underwriters on potential liability if insufficient information is provided during the offering process

The comment periods ends on January 31, 2005. [Click here](#) for the full text of the proposed rule.

SEC Finalizes Phase-In Period for Acceleration of Periodic Report Filing Dates

On November 17, 2004, the SEC adopted amendments to postpone for one year the final phase-in period for acceleration of the due dates of quarterly and annual reports required to be filed under the Securities Exchange Act of 1934 by certain reporting companies known as "accelerated filers," which are issuers that have a public float of at least \$75 million, that have been subject to the Exchange Act's reporting requirements for at least 12 calendar months, that previously have filed at least one annual report, and that are not eligible to file their quarterly and annual reports on Forms 10-QSB and 10-KSB. [Click here](#) for the full text of the SEC final phase-in. Please see our September Newsletter for more information.

SEC Issues Frequently Asked Questions on Current Report on Form 8-K

Since the publication of Release No. 34-49424, *Additional Form 8-K Disclosure Requirements and Acceleration of Filing Date*, the SEC has received a number of questions regarding the implementation and interpretation of the new Form 8-K items. On November 23, 2004, the SEC addressed the most frequently asked questions in this FAQ. The SEC reminded registrants and their counsel that one of the principal purposes of the revisions to Form 8-K is to increase the number of unquestionably or presumptively material events that must be disclosed currently, in accordance with the goals of Section 409 of the Sarbanes-Oxley Act of 2002. Registrants also should ensure that they have implemented appropriate disclosure controls and procedures in accordance with Exchange Act Rules 13a-14 and 15d-14 in order to ensure that information required to be disclosed by Form 8-K is brought to the attention of management and disclosed within the timeframes contemplated by Form 8-K. [Click here](#) for the full text of the FAQ.

Auditing Internal Control over Financial Reporting – PCAOB Updates Staff Questions and Answers

On November 22, 2004, the PCAOB issued the second supplement to its Staff Questions and Answers document originally issued on June 23, 2004. In this latest update, the PCAOB staff provides additional specific implementation guidance on three topics associated with PCAOB Auditing Standard No. 2, *An Audit of Internal Control over Financial Reporting Performed in Conjunction with an Audit of Financial Statements*. These topics are: (1) scope and extent of testing, (2)

evaluating deficiencies, and (3) using the work of others. The first supplement issued on October 6, 2004, provided specific implementation guidance on: (1) internal control and compliance with laws and regulations, (2) evaluating deficiencies at service organizations, and (3) auditing internal controls at a service organization. [Click here](#) to access the full text of the supplement.

Miscellaneous

Deloitte issues Checklists for Current Report on SEC Form 8-K and Quarterly Report on SEC Form 10-Q

Deloitte & Touche LLP offers a Checklist for Current Report on SEC Form 8-K and a Checklist for Quarterly Report on SEC Form 10-Q that is appropriate for external distribution, including to our audit clients. These checklists summarize the disclosure requirements of Forms 8-K and 10-Q. They are not to be considered "all inclusive" and are not a substitute for understanding the requirements of the form. Clients and others are presumed to have a thorough understanding of the rules, regulations, and interpretations of the SEC and its staff and should refer to those rules, regulations, and interpretations, as necessary, in considering particular items in the checklists.

[Click here](#) to access the checklist on Form 8-K and [click here](#) to access the checklist on Form 10-Q or contact your Deloitte professional.

Webcasts

Sustainable SOX Compliance for 2005 and Beyond

On December 14, 2004, Netegrity, a division of Computer Associates, and Deloitte & Touche LLP presented a web seminar that focused on lessons learned in 2004 and how these SOX requirements may be more easily achieved when activities include a focus on proper security controls.

Many firms are currently wrapping-up their first SOX compliance cycle. Since SOX compliance is clearly not a one-time event - it is an on-going initiative - the question that many firms are asking now is, "How can we do this better next time?" In this session, the presenters explore the key people, process, and technology issues that come into play when applying Identity Management to SOX 404 requirements and activities. This discussion, highlighted with first-hand experience from the presenters, explored other IT and application controls (e.g. audit trail, etc.) that can support SOX 404 requirements. [Click here](#) to access the playback of the webcast.

2004 Year-End Financial Reporting Update

On December 2, 2004, the Financial Executives Institute presented a webcast that addressed the year's financial reporting standards and developments. Panelists provided an executive summary of the most important FASB and SEC rulemaking and matters most on the minds of financial executives as they approach the Section 404 implementation deadlines. [Click here](#) to access the playback of the webcast.

Recent Deloitte Publications

Below is a list of Deloitte publications about the most recent rule proposals and legislative actions.

► [Heads Up: Vol. 11 Issue 10. 1•2•3\(R\)eady, Set, Go Fair Value Accounting for Stock Options!](#)

► [Heads Up: Vol.11, Issue 9. Accounting Highlights of the AICPA's December 6-8, 2004 SEC & PCAOB Conference](#)

► [Audit Committee Brief: November 2004](#)

A review of key regulatory, technical and professional developments in corporate governance and accounting in this Deloitte's quarterly newsletter, Audit Committee Brief.

► [EITF Roundup: November 2004](#)

► [Accounting Roundup, November 24, 2004](#)

► [Accounting Roundup, November 1, 2004](#)

► [Head Up: Vol. 11, Issue 8. Well, Isn't That Special? FASB Staff Proposes Accounting Guidance in Response to the New Tax Act](#)

► [Heads Up: Vol.11, Issue 7. Bringing Home the Bacon! New Tax Act Stimulates Repatriation of Earnings, Offers Tax Breaks to U.S. Manufacturers](#)

► [Beyond 404: Responding to COSO's New Enterprise Risk Management Framework](#)

Since 1991, the Internal Control-Integrated Framework has been an accepted U.S. authority for corporate internal control. Issued that year by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), the framework presented five interrelated components necessary for effective internal control. This paper will answer questions such as: (1) how is the new framework different than the COSO internal control mode? (2) Why should you be concerned with this? (3) What should you do differently than you are doing now? (4) What steps should you take to adopt the new COSO framework?

► [Boards under Fire](#)

Among the possible routes to improved corporate governance, enhancing board and committee education is preferred. For firms looking to follow this path, several questions arise. What topics should board education programs cover? The next issue is whether the program should be live or computer-based. Should educational programs be public seminars or restricted to one company only? Finally, you need to ask whether the company should have separate programs for each board committee. The critical concern is to get the board education program off the ground – soon. Improved governance and enhanced competitiveness await those who act decisively.

► [Accounting Roundup, October 4, 2004](#)

► [Accounting Roundup: September 10, 2004](#)

► [Accounting Roundup: Third Quarter in Review](#)

► [The New Landscape: SAS 70 in the Sarbanes-Oxley Era](#)

This publication explains how the current environment has placed focus on Statement of Auditing Standards No. 70 (SAS 70) reports and what steps are needed to assess the effectiveness of internal control over financial reporting. Companies receiving third-party services that directly impact financial reporting controls or internal control environment activities are required to provide evidence that controls

are in place both within the third-party provider and between the two organizations.

► [Avoiding Stumbles on the Path to Sarbanes-Oxley Section 404 Compliance](#)

Deloitte & Touche LLP has identified ten challenges that you should highlight on your compliance trail map as you keep your section 404 projects on track. When engaged in an ambitious effort such as Sarbanes-Oxley Section 404 compliance projects, many people have a tendency to quicken their pace once the long-sought goal finally comes into view. But this urge to accelerate on the final approach, while understandable, should be resisted, as explained in this publication.

► [Antifraud Programs and Controls Whitepaper](#)

This publication provides questions, examples, and steps for management to consider when creating and implementing antifraud programs and controls. Antifraud activities represent an important component of Sarbanes-Oxley compliance and an essential element of a COSO-based system of internal control. This document may be a useful tool as your company works to meet the requirements of the law.

► [Quality Assessment Services. Achieving Greater Enterprise Value and Better Corporate Governance through Better Effective Internal Audit Performance](#)

An independent quality assessment by companies of their Internal Audit department is required by the Institute of Internal Auditors' International Standards for the Professional Practice of Internal Auditing at least once every five years. Companies should obtain a more broad strategic assessment review, which can provide a level of comfort and understanding to boards and audit committees about their Internal Audit function's efficiency and effectiveness for assessing management's actions related to managing and mitigating enterprise risk. To obtain this publication – please contact your Deloitte professional.

► [Strategies for Going Public](#)

Deloitte's U.S. Offerings Services released an external publication, *Strategies for Going Public*, which will help companies through the initial public offering process by providing practical, working knowledge of the complex procedures involved. Helpful tools include a timetable for going public, a sample due diligence checklist, and a discussion of the new Sarbanes-Oxley requirements. The guidebook will also assist companies in optimizing teamwork by outlining the role of the company and its professional advisors in the IPO process. To obtain this publication – please contact your Deloitte professional.

► [Accounting Roundup: August 20, 2004](#)

► [Heads Up: Vol. 11, Issue 6. FASB to Tackle Two Tough Tax Topics](#)

► [Taking Control. A Guide to Compliance with Section 404 of the Sarbanes-Oxley Act of 2002](#)

► [Heads Up: Vol. 11, Issue 5. Consistency — A Fair-ly Good Idea! FASB Proposes to Make Fair Value Measurement Guidance Consistent](#)

► [Heads Up: Vol. 11, Issue 4. Who Said Retirement Is Easy? FASB Proposes to Interpret Asset Retirement Accounting](#)

► [IAS Plus Website -](#)

The International Accounting Standards Board recently revised several pronouncements, such as IAS 1, 2, 3, 8, 10, 16, 17, 24, 28, 32, 33, 39 and 40. Deloitte's IAS Plus website discusses these revisions as well as other current and future developments in the International Financial Reporting Standards (IFRS) environment.

► [E-learning training materials for International Financial Reporting Standards](#)

Deloitte is pleased to make available e-learning training materials for IFRS free of charge. [Click here](#) to Access Deloitte's IFRS e-Learning Material. Content on the following standards is now available: IAS 1, IAS 2, IAS 7, IAS 8, IAS 10, IAS 11, IAS 14, IAS 16, IAS 17, IAS 18, IAS 21, IAS 27, IAS 28, IAS 31, IAS 34, IAS 37, IAS 40, IAS 41, and the Framework for the Preparation and Presentation of Financial Statements. Modules on the remaining standards are currently being developed and will be released in phases throughout 2004.

Other useful publications can be obtained on Deloitte's website – [Click here](#)

[Back to top](#)

* * *

GAAP Matters

Consensus on EITF Issue No. 03-13, *Applying the Conditions in Paragraph 42 of FASB Statement No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, in Determining Whether to Report Discontinued Operations*

Consideration of the guidance in paragraph 42 of Statement 144 has generated questions about how to apply the criterion that the operations and cash flows be eliminated from the ongoing operations of the reporting entity (the "ongoing entity"). Specifically, which cash flows of the disposed component have to be eliminated from the ongoing operations of the entity (Issue 1)? Additionally, questions have been raised about the types of continuing involvement that constitute significant continuing involvement (Issue 2).

The Task Force reached a consensus that classification of a disposed component as a discontinued operation is appropriate only if the ongoing entity:

Step 1: Has no **continuing direct cash flows** (a term Issue 03-13 introduces to interpret paragraph 42(a)), and

Step 2: Does not retain an interest, contract, or other arrangement sufficient to enable it to exert significant influence over the disposed component's operating and financial policies after the disposal transaction (an interpretation of paragraph 42(b)).

Step 1

In essence, the Task Force defined "direct cash flows" in a manner that permits the continuation of insignificant cash flows between the discontinued operation (or the customers of the discontinued operation) and the ongoing entity. This reconciles paragraph 42(a) of Statement 144 (requiring an **elimination** of cash flows) to the intention of the Board to increase the number of entities reporting discontinued operations.

Direct cash flows of a component include gross cash flows (cash inflows and cash outflows) that are associated with continuing revenue-producing and/or cost-generating activities of that component. Direct cash flows occur if the ongoing entity is expected to recognize:

- **Significant** cash inflows or outflows as the result of a **migration of revenues or costs from the disposed component** after the disposal transaction, **or**

- **Significant** cash inflows or outflows from a **continuation of activities between the ongoing entity and the disposed component** after the disposal transaction. For example, assume a manufacturer makes and sells a product to company owned retail stores. If the company sells its manufacturing business but continues to purchase the product for its stores from the sold manufacturing business, the ongoing purchase represents a continuation of activities.

A migration occurs when the ongoing entity expects to continue to generate revenues and/or incur expenses from the sale of similar products or services to specific customers of the disposed component. Issue 03-13 does not require an entity to track the identity of the individual customers who are expected to migrate in order to conclude whether a migration has occurred. The Task Force also determined that if the ongoing entity continues to sell a commodity on an active market after the disposal transaction, there is a presumption that migration occurs. This presumption may be overcome based on facts and circumstances, such as the lack of similarity of commodities or whether the sale of the commodity after the disposal transaction occurs in a different geographic region.

This step requires a consideration of the expected gross revenues and costs that will remain in the ongoing entity as a result of migration and/or a continuation of activities compared to the total gross revenues and costs that the disposed component would have recorded, absent the disposal.

The Task Force rejected establishing a *bright line* to determine "significant"; what is significant (and thus direct) depends instead on facts and circumstances.

By way of illustration, consider whether the disposed component in the following example qualifies for income statement presentation as a "discontinued operation":

Example

A retailer closes all of its stores in one region (assume each store represents a "component" of entity). However, the customers of the closed stores can continue to purchase the same type of merchandise from the retailer's Web site and catalog. Some of the customers of the disposed components are expected to "migrate" and become customers of the retailer's Web site, and/or catalog. Have all cash flows of the components been eliminated if some of their customers are still purchasing the same product from the retailer?

The retailer recognized \$1 million in annual revenues from its disposed components prior to their disposal. Some of the customers of the disposed component are expected to "migrate" and become customers of the retailer's Web site and catalog. Ongoing annual sales (via the Web site and the catalog) to these customers is expected to be \$500 thousand. That is, the ongoing entity is expecting 50 percent migration of revenues. Because the migration results in a significant continuation of cash flows, the disposed component should not be displayed in discontinued operations.

Step 2

The Task Force determined that the relevant consideration to determine whether the ongoing entity will have significant continuing involvement is whether the ongoing entity will be able to exert significant influence over the operating, and/or financial policies of the disposed component. The retention of risk or the ability to obtain benefits associated with the ongoing operations of the disposed component is not explicitly considered by itself to be continuing involvement for the purpose of this Issue. However, the Task Force believes the retention of risks and rewards may be relevant in an overall assessment of whether the ongoing entity can exert significant influence.

See Appendix below for the decision tree to determine when a component should be classified as a discontinued operation.

Assessment Period

The assessment of whether a disposal must be reported as a discontinued operation should include a consideration of management's intent and ability regarding future cash flows and significant continuing involvement. The assessment period:

- Begins when the component initially meets the criteria to be classified as held for sale or has been disposed,
- Ends one year after the date on which the component is actually disposed, and
- Can extend beyond one year after disposal due to circumstances beyond an entity's control (e.g., legal or regulatory requirements that extend a continuation of activities).

An entity is only required to reassess its previous evaluation when significant events or circumstances make it likely that the criteria in paragraph 42 will (or will no longer) be met within the assessment period.

The evaluation of whether the criteria in paragraph 42 are expected to be met should include significant events or circumstances that occur after the balance sheet date but before the issuance of the financial statements.

Additional Illustrations of Discontinued Operations Reporting under FASB Statement No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets:

Examples of Continuing Cash Flows

Many real estate companies that own a portfolio of commercial buildings are dissatisfied with discontinued operations under Statement 144. Because each individual building often is a "component," the sale of a building often results in it being reported as a discontinued operation. Because they look at their property portfolios as ongoing, these real estate companies object to a change in the portfolio's composition as being reported as a discontinued operation. In short, these companies would prefer to report discontinued operations based on business lines rather than based on components, as required by Statement 144.

The Task Force also determined that if the ongoing entity continues to sell a commodity on an active market (after the disposal of a component that sold the same commodity), there is a presumption that migration occurs. The presumption may be overcome based on facts and circumstances, (e.g., the commodities are not in fact identical or the ongoing entity sells the commodity after the disposal in a different geographic region).

Examples of Assessment and Reassessment Provisions

An entity is only required to reassess its previous evaluation when significant events or circumstances make it likely that the criteria in paragraph 42 will (or will no longer) be met within one year after the disposal date.

Example 1

A company owns several commercial buildings (assume each building is a "component") that are leased to third-party lessees.

The company disposes of one of its buildings. The ongoing entity will purchase another commercial building in the same geographic area. The ongoing entity does not anticipate that any of the lessees from the sold building will terminate their leases and migrate to the new building; however, the ongoing entity believes that certain lessees also will be lessees in the new building.

In this example, a migration would not be expected to occur. Even though the same customer (an individual lessee) also may lease from the new building, the Task Force emphasized that the relevant test is whether the lessee actually migrated from the disposed component. Therefore, the company would display the component as a discontinued operation.

Example 2

A company owns an oil field in one region and sells into an active market. The company disposes of the oil field but brings another field of similar capacity on-line. The ongoing entity will sell the oil into the same active market. In this example, a migration would be expected to occur, and, therefore, the company would not report the disposed component as a discontinued operation because all of the sales of the new field represent migration.

Example 3

A company determined at March 31, 2005, that a component disposed of on March 15, 2005, was not a discontinued operation solely because the ongoing entity maintained an equity method investment in the disposed component (i.e., significant continuing involvement). On June 15, 2005, the company sold its equity method investment, and, thus, no longer had the ability to exert significant influence over the operations of the disposed component. As a result, the disposed component qualifies as a discontinued operation.

Disclosures

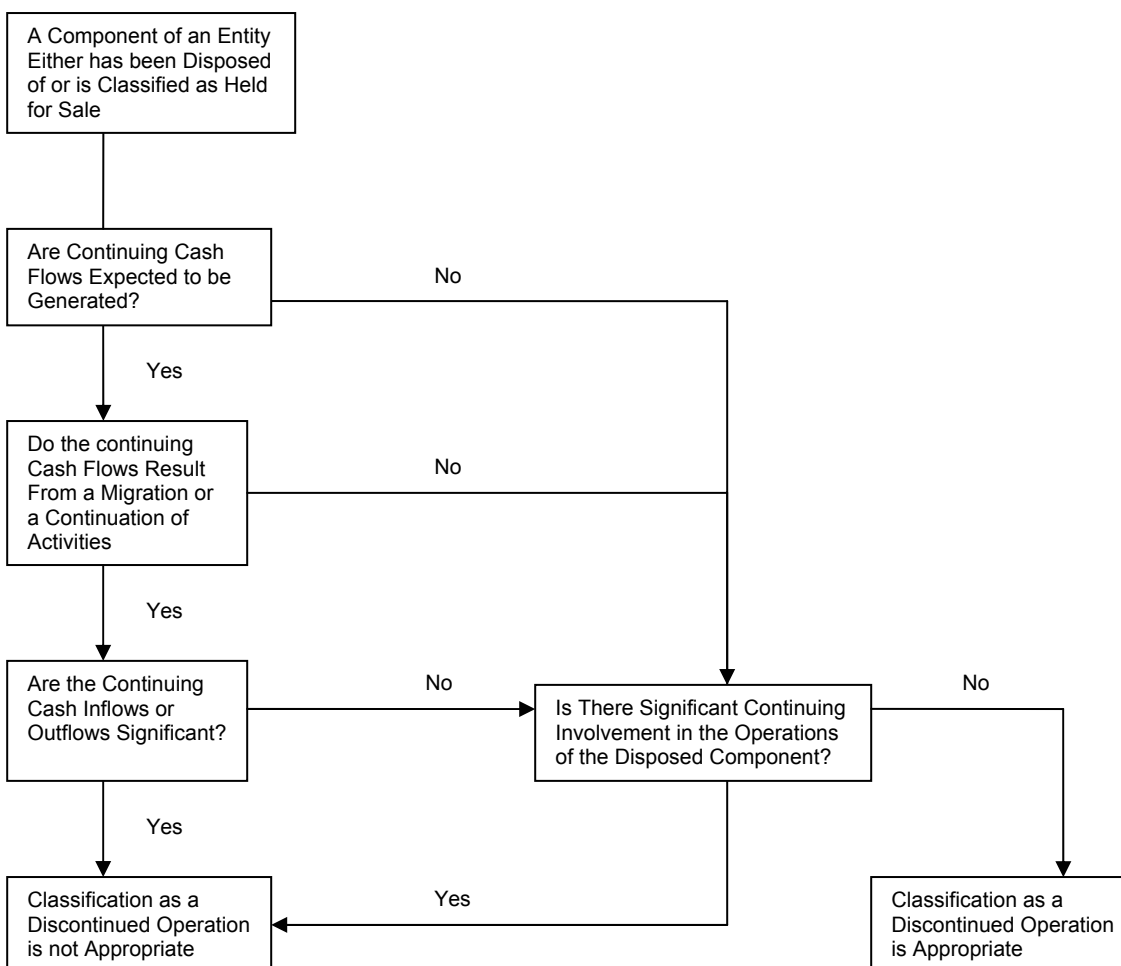
As used in this document, the term "Deloitte" includes Deloitte & Touche LLP, Deloitte Consulting LLP, and subsidiaries.

Issue 03-13 requires disclosures for **each discontinued operation that generates continuing cash flows or results in continuing involvement**:

- The nature of the activities that give rise to continuing cash flows,
- The period of time continuing cash flows are expected to be generated,
- The principal factors used to conclude that the expected continuing cash flows are not direct cash flows of the disposed component,
- The amount of intercompany revenues, if any, that are no longer eliminated as a result of the disposal of the component, and
- A description of the types of continuing involvement, if any. [Click here](#) to access November EITF Roundup and [click here](#) to access the full text of the EITF Meeting Minutes on Issue No. 03-13.

[Back to top](#)

Appendix. Determining When a Component Should be Classified as a Discontinued Operation



* * *

[Back to top](#)

What is and How to Subscribe DART?

Deloitte makes available, on a subscription basis, its online library of accounting and financial disclosure literature. Called the Deloitte Accounting Research Tool (DART). The library includes material from the FASB, the EITF, the AICPA, the SEC, and the IASB, in addition to Deloitte's own accounting manual and other interpretative accounting guidance.

Updated every business day, DART has an intuitive design and navigation system, which, together with its powerful search features, enables users to quickly locate information anytime, from any computer. Additionally, DART subscribers receive periodic e-mails highlighting recent additions to the DART library.

The fee for a subscription to the DART is \$1,500 per person per year plus applicable sales tax. You can subscribe to the DART on-line and pay using any of the following credit cards: American Express, Diners Club, Master Card, or Visa. You can also subscribe to DART by calling 1-800-877-0145.

For more information, including subscription details and an online DART demonstration, visit: <http://www.deloitte.com/us/dart>

This document is intended for non-US based companies and can be distributed externally to clients and prospective clients.

Deloitte & Touche LLP is not, by means of this publication, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This publication is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor. Deloitte & Touche LLP shall not be responsible for any loss sustained by any person who relies on this publication

About Deloitte

Deloitte, one of the nation's leading professional services firms, provides audit, tax, consulting, and financial advisory services through nearly 30,000 people in more than 80 U.S. cities. Known as an employer of choice for innovative human resources programs, the firm is dedicated to helping its clients and its people excel. "Deloitte" refers to the associated partnerships of Deloitte & Touche USA LLP (Deloitte & Touche LLP and Deloitte Consulting LLP) and subsidiaries. Deloitte is the U.S. member firm of Deloitte Touche Tohmatsu. For more information, please visit Deloitte's Web site at www.deloitte.com/us.

Deloitte Touche Tohmatsu is an organization of member firms devoted to excellence in providing professional services and advice. We are focused on client service through a global strategy executed locally in nearly 150 countries. With access to the deep intellectual capital of 120,000 people worldwide, our member firms, including their affiliates, deliver services in four professional areas: audit, tax, consulting, and financial advisory services. Our member firms serve more than one-half of the world's largest companies, as well as large national enterprises, public institutions, locally important clients, and successful, fast-growing global growth companies.

Deloitte Touche Tohmatsu is a Swiss Verein (association), and, as such, neither Deloitte Touche Tohmatsu nor any of its member firms has any liability for each other's acts or omissions. Each of the member firms is a separate and independent legal entity operating under the names "Deloitte," "Deloitte & Touche," "Deloitte Touche Tohmatsu," or other, related names. The services described herein are provided by the member firms and not by the Deloitte Touche Tohmatsu Verein. For regulatory and other reasons, certain member firms do not provide services in all four professional areas listed above.