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COOPER INDUSTRIES, LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

	Year Ended December 31		
	2004	2003	2002
		(in millions)	
Net income, as reported	$ 339 8	$ 148 3	$ 213 7
Add Stock-based employee compensation expense included in reported net income, net of related tax effects	13 3	6 3	(1 0)
Deduct Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(14 6)	(12 6)	(12 9)
Pro forma net income	$ 338 5	$ 142 0	$ 199 8
Earnings per share			
Basic – as reported	$ 3 67	$ 1 60	$ 2 29
Basic – pro forma	$ 3 66	$ 1 53	$ 2 14
Diluted – as reported	$ 3 58	$ 1 58	$ 2 28
Diluted – pro forma	$ 3 57	$ 1 52	$ 2 14

Impact of New Accounting Standards: In January 2003, the Financial Accounting Standards Board issued Interpretation No 46, *Consolidation of Variable Interest Entities* (the "Interpretation"), an interpretation of Accounting Research Bulletin No 51 The Interpretation requires the consolidation of variable interest entities in which an enterprise absorbs a majority of the entity's expected losses, receives a majority of the entity's expected residual returns, or both, as a result of ownership, contractual or other financial interest in the entity For variable interest entities created before February 1, 2003 the Interpretation was effective during the first interim period ending after December 15, 2003 Adoption of the Interpretation had no effect on Cooper's consolidated results of operations, financial position or cash flows

In May 2004, the Financial Accounting Standards Board issued FASB Staff Position 106-2 *Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003* ("FSP 106-2") FSP 106-2 provides guidance on accounting for the effects of the new Medicare prescription drug legislation by employers whose prescription drug benefits are actuarially equivalent to the drug benefit under Medicare Part D Cooper concluded that the effects of FSP 106-2 did not constitute a significant event Accordingly, Cooper incorporated the effects of FSP 106-2 in the measurement of assets and obligations of affected postretirement plans at December 31, 2004 resulting in an $11 3 million reduction in the accumulated postretirement benefit obligation

In December 2004, the Financial Accounting Standards Board issued FASB Statement 123(R), *Share-Based Payment*, which is a revision of SFAS No 123 The revised statement is effective at the beginning of the first interim period beginning after June 15, 2005 Statement 123(R) must be applied to new awards and previously granted awards that are not fully vested on the effective date Cooper adopted SFAS No 123 using the prospective transition method which applied only to awards granted, modified or settled after the adoption date Accordingly, compensation cost for some previously granted awards that were not recognized under SFAS No 123 will be recognized under Statement 123(R) However, had we adopted Statement 123(R) in prior periods the impact of that standard would have approximated the impact of SFAS No 123 as described in the disclosure of pro forma net income and earnings per share above Statement 123(R) also requires the benefits of tax deductions in excess of recognized compensation cost be reported as a financing cash flow, rather than as an operating cash flow as required under current literature This requirement will reduce net operating cash flows and increase net financing cash flows in periods after adoption While Cooper cannot accurately estimate what those amounts will be in the future (as they depend on, among other things, when employees exercise stock options), the amount of operating cash flows recognized for such excess tax deductions were $5 3 million, $6 4 million and $0 6 million in 2004, 2003 and 2002, respectively