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AICPA Board/Council Briefing Synopsis Updated as of December 29, 2004

American Institute of Certified Public Accountants (AICPA)

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December 29, 2004,

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SARBANES-OXLEY IMPLEMENTATION

- The Act laid out a definitive timetable for the implementation of its various provisions. Much of the implementation was the responsibility of the SEC, and once appointed, the new PCAOB.
- The AICPA is very engaged in the process in a way that is highly appropriate – working with PCAOB and SEC on the effective implementation on Sarbanes-Oxley.
- The SEC proposed, received comments on, and has approved a host of new rules designed to implement various provisions of Sarbanes-Oxley.
- The AICPA – through the combined efforts of volunteers and staff – has commented on, and we believe, had a positive impact on, each of the new rules that are now in place.
- The AICPA Web Site has a Sarbanes-Oxley PCAOB Central area with links to the SEC & PCAOB proposals, final rules, public statements etc. as well as AICPA comment letters and public statements. http://www.aicpa.org/sarbanes/index.asp
- The PCAOB is up and running with former Fed Governor William McDonough as Chair, and senior staff in place to manage the Board's key functions including inspections of public accounting firms and establishing standards for the audits of issuers.
- The PCAOB's rulemaking process results in the adoption of rules that are then submitted to the Securities and Exchange Commission for approval. PCAOB rules do not take effect unless approved by the Commission.
- As of February 2004, the PCAOB has issued proposals, accepted comments and voted on final rules in a number of areas related to its key functions. The complete set of rules can be viewed on the Board's Web site www.pcaobus.org .
- The AICPA has been actively reviewing and commenting on these proposals on behalf of its members.
- Our comment process involves a coordinated effort among volunteers and staff with knowledge and experience in auditing standards, ethics, peer review and other aspects of professional practice.
- Going forward, these efforts are being coordinated through the Center for Public Company Audit Firms and its Executive Committee.

SARBANES-OXLEY IMPLEMENTATION

Sarbanes-Oxley Act of 2002

- Enacted July 30, 2002
- Creates the Public Company Accounting Oversight Board or PCAOB, funded by accounting firms and registrants
- Revises corporate governance standards
- Adds new disclosure requirements
- Creates new federal crimes related to fraud
- Significantly increases criminal penalties for violations of the securities laws
- The Act ***directly*** covers "issuers" (about 15,000 public companies)
    - Companies required to file periodic reports with the SEC
    - Companies with more than $1,000,000 in total assets and at least 500 shareholders
    - Companies who have registered securities with the SEC
    - Companies that are "in registration"

The AICPA Position

- The AICPA's position on Sarbanes-Oxley is clear and has been repeated at every opportunity.
- We believe that the Sarbanes-Oxley's provisions are appropriate for SEC-registered public companies and their auditors.
- On the whole SOX will contribute to the protection of the public interest.
- We've gone to significant lengths to help our members and the federal government to implement them – so that their *intended* impact can be maximized.

SARBANES-OXLEY IMPLEMENTATION

Key Sarbanes-Oxley Provisions

Here's a brief outline – by section of the Act – of the key provisions for auditors and their clients.

- 201 – Prohibits auditors from providing a list of eight specific non-audit services to audit clients. Audit committees must approve all audit and non-audit services in advance.
- 203 – Calls for mandatory rotation of audit "partners"
- 204 – Spells out the reporting from the auditor to the audit committee re: "critical accounting policies," "alternative methods of recording transactions"
- 206 – Prohibits the client from hiring audit personnel into senior positions for one year
- 207 – Requires the GAO to study audit "Firm" rotation
- 209 - State regulators are directed to make an independent determination as to whether the Board's standards shall be applied to small and mid-size non-registered accounting firms
- 301 – Describes the responsibilities of audit committees and the requirement of its members to be independent
- 302 - Requires CEOs and CFOs to certify financial statements filed with the SEC
- 303 – Makes it unlawful for company officers and directors to mislead the auditor
- 306 – Prohibits insider trading in a company stock during pension fund blackout periods
- 401 – Deals with required disclosures for periodic reporting, pro-forma financial statements and asks SEC to review off-balance sheet reporting and disclosure
- 402 – Prohibits personal loans to corporate executives
- 403 – Requires the disclosure of transactions by insiders
- 404 – Requires management to assess internal controls and an auditors report on that assessment
- 406 – Requires the adoption of a "code of ethics" for senior financial officers
- 407 – Requires a report on the financial expertise of audit committee members
- 409 – Requires "real time" disclosures of material changes to the issuer's financial condition

ANTIFRAUD AND CORPORATE RESPONSIBILITY PROGRAM

- Last year, the AICPA launched a comprehensive Antifraud and Corporate Responsibility Program designed to rebuild investors' confidence in our capital markets and re-establish audited financial statements as a clear picture window into corporate America.
- The program developed a wide range of new resources and tools that together work to prepare AICPA members to implement SAS 99 and to help corporate America combat financial statement fraud.
- As the cornerstone of the AICPA's Antifraud and Corporate Responsibility Program, the Auditing Standards Board issued a new audit standard, Statement on Auditing Standards (SAS) 99, *Consideration of Fraud in a Financial Statement Audit*, in October 2002. The SAS gives auditors considerably more guidance for detecting material fraud. It puts U.S. auditors on notice that they must approach every audit with enhanced professional skepticism.
- In an effort to work with corporate America to prevent fraud, the AICPA, working with other organizations, created a document entitled *Management Antifraud Programs and Controls: Guidance to Help Prevent and Deter Fraud*, that spells out specific recommendations to help boards of directors, audit committees, and management prevent and root out fraud. This document is available as an exhibit to SAS 99 as well as a stand alone document. Corporate antifraud programs and controls, the document explains, must have three fundamental components: a culture of honesty and high ethics, antifraud processes and controls, and an appropriate oversight process.
- The AICPA launched a new Antifraud and Corporate Responsibility Resource Center at www.aicpa.org/antifraud. It features free technical literature designed to support the CPA's perspective—whether an auditor, a consultant or a member in business and industry or government—within the engagement context; educational materials; training; news on recent developments; and links to supporting products and services. The site's newest enhancement is a section for educators and students that provides instructors with materials, including case studies, to help bring fraud prevention, detection and related issues into the classroom, and enables students to explore career possibilities and access educational resources.
- To help businesses prevent and detect fraud, the AICPA and the Association of Certified Fraud Examiners (ACFE) released a one-hour antifraud training program on CD-ROM, "How Fraud Hurts You and Your Organization." It includes real-life examples of fraudulent activity and a checklist of warning signs. More than 100,000 CD-ROMs have been distributed free of charge to CPA firms and businesses across the United States.
- A new, 8-hour CPE course, "Fraud and the CPA" also was developed by the AICPA and ACFE. The course highlights how CPAs can better assist corporate America in detecting and preventing all types of fraud.
- The AICPA Business and Industry Team, with support from the AICPA Foundation, published a series of case studies of unethical and illegal accounting practices based on real-life experiences of members. The case studies include expert commentary offering alternatives on how to face unfamiliar situations. The case collection is available through www.aicpa.org, in the Antifraud and Corporate Responsibility Center.

ANTIFRAUD AND CORPORATE RESPONSIBILITY PROGRAM

- To allow CPAs to determine how well their overall skills and proficiencies compare to composite profiles, the AICPA introduced the Competency Self-Assessment Tool. The tool includes a variety of competency models, including fraud prevention, detection and investigation. It is located at http://www.cpa2biz.com/CPEconferences/cat.htm.
- The AICPA with the University of Texas at Austin and the Association of Certified Fraud Examiners continues to develop a research/think tank to develop superior approaches to prevent, detect, deter and punish fraud and corruption. The still-to-be-named organization will prioritize and support research to determine the extent of fraud and corruption, track trends, document fraud techniques, and predict the environments that lead to fraud and corruption.
- The AICPA developed a collection of antifraud case studies and ethics for educators to use in the classroom. These studies were culled from the AICPA Professor Practitioner Case Development Program. While they focus on fraud, they also address a wide range of topics, including ethics and corporate governance. In addition, SAS 99 teaching notes were distributed and questions focused on fraud detection were incorporated into the CPA Exam.

OUTREACH PROGRAMS

- Jim Castellano, in his year as AICPA Chair, called for and launched a new member outreach program to encourage healthy two-way dialogue with members and hopefully foster better understanding on the issues affecting the profession.
- We organized this initiative with three primary audiences: the members, the Council and state society leaders and the state society staff.
- For the Members:
  - We have asked the state societies to invite members of the Board and designated senior staff to speak at their major meetings. During these visits, the AICPA representatives will aim to participate in at least one adjunct meeting with Society leaders, Council members or a firm or large employer. Our goal is to reach 50 states annually.
  - We launched and are seeking to enhance our new electronic communication program. The new electronic AICPA Update has been very well received by the membership. It quickly highlights 4-6 issues affecting the profession.
  - We have begun a campaign to increase the percentage of members for whom we have e-mail addresses for. Since the campaign began, we have increased the percentage from 52% to 70%; but, we still have much work ahead.
- For Council and Society leaders:
  - In July 2002, we began producing a video summary immediately following each Board of Directors meeting. This program is sent electronically to all Council members, AICPA committee and task force chairs, top volunteer leaders and chief staff officers of state societies.
  - We have begun to hold conference call briefings for Council members in August and January to supplement the in-person meetings of Council in May and October. We also continue to conduct conference call briefings with the state society leaders each quarter.
  - We have asked each Board member to serve as a liaison with several state societies. We have asked the Board members to attend at least one society Board meeting during the year. The response from the societies to this initiative has so far been very positive.
- For State Society staff:
  - We have asked select AICPA staff members to visit state society offices as an adjunct to their normal travel. We hope to visit 20 state society offices annually.
  - The State Society Relations Team is continuing its weekly communication highlights with URL links.
  - We re-established the state society new chief staff officer orientation program and we are continuing the CPA/SEA annual briefing with the AICPA's executive staff.
- These are some of the Outreach initiatives we have begun. If you have other suggestions, we would like to hear them.

THE AICPA/NASBA UNIFORM ACCOUNTANCY ACT (UAA)

Issue and Background

- The AICPA/NASBA Uniform Accountancy Act (UAA) is an evergreen model licensing law that was developed to provide a uniform approach to regulation of the accounting profession.
- In general, the UAA- promotes the following key concepts aimed at mobility and easing reciprocity, while strengthening public protection. The UAA:
  - Protects the pubic interest by bolstering provisions relating to the most critical service area--attest --and ensuring that all those who use the CPA title adhere to an appropriate level of professionalism. It also underscores the enforcement authority of state boards over CPAs who practice interstate.
  - Promotes equality among CPAs by ensuring that all who wish to use the CPA title are licensed and subject to the state board's regulation regardless of their field of employment.
  - Facilitates mobility across state lines so that CPAs can more easily serve clients and employers outside the state where they are licensed.

Core Provisions of the UAA

Substantial Equivalency

- Substantial Equivalency is the cornerstone of the UAA.
- Under this concept, a CPA with a license in good standing, from a state using certification criteria that are essentially those outlined in the UAA, would be qualified to practice in a state other than the CPA's principal place of business.
- CPAs who practice across state lines in person or via electronic technology would not be required to obtain an additional license if they hold a valid license from another state that is deemed substantially equivalent.
- The CPA must notify the state board in the state in which the service will be performed.

CPA=CPA

- The UAA requires all individuals wishing to use the CPA title to hold a valid license, regardless of their particular field or place of employment.
- As long as individuals hold a CPA license, they are subject to the state board of accountancy's authority, regardless of what they do for a living or whether they use their CPA title.

THE AICPA/NASBA UNIFORM ACCOUNTANCY ACT (UAA)

CPAs Working in Non-CPA Firms

- Under the UAA, with the exception of traditional attest services, CPAs may offer services to the public while working in non-CPA firms or other business entities.
- CPAs may offer "non-attest" services through entities that are exempt from state accountancy board regulation provided those entities do not call themselves CPA firms or use the term "CPAs" in association with the entity's name.
- Regardless of whether the entity is subject to regulation, the CPAs in the entity are always individually subject to the authority of the state board.

Regulation of CPA Firms / Mandatory Peer Review

- CPAs wishing to offer traditional "attest services" must do so in a duly licensed CPA firm.
- The firm must undergo peer review every three years and assure that CPAs in the firm supervising such services and signing off on financial statements meet experience requirements that are defined in professional standards.
- The UAA permits individuals to perform compilations outside a licensed firm; as long as they are performed according to professional standards and that the individual undergoes peer review once every three years.
- A majority ownership of the firm—both in terms of financial interests and voting rights—must reside with individuals licensed as CPAs in the state of their principal place of business. All non-CPA owners must be active participants in the firm or its affiliates.

Attest Services

- The UAA defines attest services to include audits, reviews, and examinations of prospective financial information performed in accordance with applicable professional standards.
- Performances of these attest services, on which third parties rely, are restricted to licensed individuals and firms.
- In addition, licensees or firms cannot accept commissions or contingent fees for products or services provided to clients for whom they also provide attest services.

Experience

- A broad requirement calls for one year of professional experience using accounting, attest, management advisory, tax or consulting skills in government, industry, academia or public practice, all of which must be verified by a licensee.

THE AICPA/NASBA UNIFORM ACCOUNTANCY ACT (UAA)

- While the UAA broadens the experience requirement for initial licensing, it requires additional specific competency for individuals charged with supervising performance of attest services and signing or authorizing someone to sign the accountant's report on financial statements, thus further protecting the public interest.
- Individuals must comply with the appropriate competency requirement for such services as dictated by the *Statement on Quality Control Standards; the Personnel management Element of a Firm's System of Quality Control – Competencies Required by a Practitioner-in-Charge of an Attest Engagement*.

Recent Activities

Changes to the UAA Rules Process

- In the summer of 2003, the AICPA and NASBA agreed to a more streamlined process by which *Rules* for the UAA will be written and adopted.
- Under the new process, NASBA will have authority for approving and finalizing the UAA Rules, with the AICPA retaining a significant role in the process.
- While the UAA Rules will no longer be a joint AICPA/NASBA endeavor, the AICPA will continue to support the Rules process with staff and technical resources and the AICPA's UAA Committee members also will devote time to the Rules process.
- The AICPA and NASBA continue to work jointly on the UAA statute.

New UAA Rules Adopted by NASBA

- On July 30, 2004 the NASBA Board of Directors approved the following four rules:
  - Rule 6-8 Interstate Practice Privileges
  - Rule 7-5 Submission of Peer Review Reports to the Board of Accountancy
  - Rule 7-8 Audit Documentation Retention
  - Rule 11-2 Self Reporting Requirements

State Action

- The AICPA continues to provide implementation assistance to state CPA societies. Educational materials that include:
  - Videos
  - PowerPoint presentations, talking points, issue briefs and question/answer documents are available.
  - A copy of the UAA and educational materials can be obtained from the AICPA Web site at: www.aicpa.org.

ENHANCED DISCIPLINE

- The AICPA holds our members to the highest professional standards. We are intolerant of those who break the rules and are committed to retaining and reinforcing the public's trust. The public's trust is our most valuable asset and our disciplinary process must help preserve that.
  - A number of proposals to strengthen our disciplinary process have been approved by our governing Council and voted into place by our members through a member referendum. The proposals involve:
- The ability to admonish a member with publication of that finding.
  - An admonishment sanction gives us more flexibility and would align the PEEC's sanctions with those of the AICPA's Joint Trial Board as well as with other bodies that regulate CPAs, such as the SEC and state boards of accountancy.
  - This is now in effect with the approval of Council in Spring 2003.
- An enforcement policy that will allow us to utilize the results of investigations performed by certain governmental and private regulatory bodies, such as the SEC and the new Public Company Accounting Oversight Board (PCAOB).
  - Members and the PEEC would each have the right to appeal the automatic sanction.
  - Members recently voted in overwhelming numbers to approve this change.
- Enhanced transparency of the disciplinary process.
  - We believe that more complete and widespread publication of disciplinary matters is in the public interest and that these enhanced disclosure requirements will provide the public and our members with a more complete picture of the AICPA's disciplinary process. It also will act to deter practitioners from future violations of the Code.
  - This provision was also passed by a member vote and is now being put into place.

SIGNIFICANT CLIENTS/FEE DEPENDENCY

- In response to concerns expressed by the business community, lawmakers, and others about the possible effect of significant client fees on an auditor's independence and objectivity, the AICPA has undertaken an effort to study the matter.
- The AICPA appointed a task force comprised of members of the PEEC and the (former) SEC Practice Section (SECPS) Peer Review Committee and AICPA Peer Review Board. The charge of the task force was to identify the methods employed by various accounting firms for ensuring that the significance of a client does not result in the loss of objectivity necessary to conduct the audit and to extract from the various methods those that, in the opinion of the task force, represent "best practices."
- The task force sent questionnaires to AICPA members consisting of a wide array of local, regional, and national firms in order to determine firms' policies and procedures for identifying significant clients and protecting against the potential loss of auditor objectivity where a client was significant to the firm, a partner, or office of the firm.
- The PEEC compiled a list of what it believed to be best practices and forwarded this information to the Auditing Standards Board's Quality Control Task Force for inclusion in its *Guide for Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing Practice*.
- The PEEC also incorporated the best practices guidance into its *Plain English Guide to Independence* which is free to members and available on the AICPA Web site.
- The PEEC will also consider developing a standard addressing significant clients under rule 102—Integrity and Objectivity.

ENHANCED BUSINESS REPORTING

- Executives and investors alike recognize the importance of non-financial measures of business performance.
- Information about such qualitative aspects of operations as strategic planning, employee turnover, and customer loyalty are not typically reported to corporate boards and investors, yet thousands of successful executives run their businesses using them.
- With U.S. mutual funds ownership exceeding 90 million individuals, there is a compelling argument that people are the “institution” driving the capital markets… people who are now, or will become, dependent on these assets to sustain their quality of life during retirement.
- Because of this dependency, the participants in the business reporting supply chain should reach the conclusion that high quality and transparent information is clearly the highest and best outcome for the public interest.
- Meanwhile, the Sarbanes-Oxley Act, the creation of the Public Company Accounting Oversight Board, a potential use of principles-based accounting standards and the internationalization of these standards require businesses to be more open and accountable to their investors and the public.
- There is a growing recognition among the commissioners and staff of the Securities and Exchange Commission (SEC) to provide key performance indicators and information about opportunities, risks, and management’s strategies and plans.
- This reexamination of corporate reporting, governance, and legal requirements has created a national climate more likely to embrace the use of performance and strategic measures of a company’s performance.
- A rich history of study and debate exists on this topic. Ten years ago, a special committee led by Ed Jenkins, later to become chairman of FASB, produced Improving Business Reporting—A Customer Focus. The Jenkins Report, as it came be known, shaped further study and discussion of this topic.
- In 1999, a group organized by the AICPA and the Brookings Institution produced a series of books and papers and testified before Congress on the importance of broader corporate disclosure to their shareholders.

<u>The Special Committee on Enhanced Business Reporting</u>

- Against this background, the AICPA created the Special Committee on Enhanced Business Reporting. The objective of the committee’s work is simple: improve the quality and transparency of business reporting as part of the process to rebuild investor confidence and protect capital markets.

ENHANCED BUSINESS REPORTING

- After a year's work, the committee, chaired by Mike Starr of Grant Thornton, has produced *Quality and Transparency in Business Reporting: A call to action... in the Public Interest*, a policy paper outlining the benefits of enhanced business reporting and recommending steps leading to adoption of the concept.
- To achieve the Special Committee's mission—"to establish a consortium of investors, creditors, regulators, management and other stakeholders to improve the quality and transparency of information used for decision-making"—the members decided an Advisory Council of prominent U. S. business and civic leaders should be formed.
- Ned Regan, the president of New York's Baruch College and the former New York State comptroller, has agreed to serve as chair of the Advisory Council. As chair, he will identify and recruit business and civic leaders to form the Advisory Council comprising 5 to 8 members. Baruch College's Center for Financial Integrity will assist in these efforts.

Enhanced Business Reporting Consortium

- When fully organized, the Consortium will be independent, with financial support coming from the AICPA and several participating organizations.
- It is expected that academic and foundation partners in other parts of the country will be recruited to join with Baruch College in supporting the Consortium's activities.

A Framework for Reporting

- Ultimately, conceptual frameworks and rules, regulations, and laws are of no value unless people act with integrity. What really matters is people doing the right thing and holding themselves accountable for the consequences of their actions. From this universal truth, we can begin to build a framework for enhanced business reporting.
- The foundation for the enhanced business reporting framework is strong corporate governance. Corporate governance is a board of directors and management demonstrating a fierce commitment to integrity; demanding excellence in all efforts; providing leadership, that is providing direction, focus, and motivation; and, displaying respect for people, ethical standards, laws, and regulations.
- The special committee envisions a pragmatic base from which to start the long-term process of developing many solutions to meet the needs of 21st century capital markets. The first steps include a "three-pronged" approach to enhanced business reporting:
    - Financial statements based on global generally accepted accounting principles
    - Key performance indicators based on industry-specific definitions and principles
    - Company specific information about strategy, plans, opportunities, and risks, that is, management's view of the business environment and their strategy to create value

ENHANCED BUSINESS REPORTING

The benefits of enhanced business reporting

- Widespread implementation of enhanced business reporting will contribute to ongoing efforts to rebuild investor confidence and protect capital markets. In fact, academic research and papers published by standards-setting organizations have identified benefits attributed to disclosure of key performance indicators and high-earnings quality.
- Several of the benefits to consumers, preparers, and the general economy are outlined below:
  - **Investors and creditors** benefit from:
  - Reduced likelihood that they will misallocate their capital
  - Better understanding of an entity's operations
- **Companies and management** benefit from:
  - "…discounts of 80-160 basis points in their average cost of debt and 150-300 basis points in their average cost of equity relative to firms with the poorest earnings quality." (*The Market Pricing of Earnings Quality*, October 2002, an unpublished research paper)
  - Enhanced credibility and clearer communication with stakeholders
- **Regulators** benefit from:
  - Restoration of trust and confidence in business reporting
  - More efficient and effective regulatory processes
- The **general economy** benefits from:
  - Strengthened global competitiveness due to stability in the capital markets
  - Increased foreign investment

The challenge for all stakeholders

- Agreement on and implementation of enhanced business reporting will require unprecedented cooperation, collaboration, and dialogue between the members of the business reporting supply chain. This will be an arduous task; its magnitude and scope cannot be underestimated. However, it is often said that every journey, regardless of length or steepness of terrain, begins with a single step.

PRIVATE COMPANY FINANCIAL REPORTING

- AICPA Chairman Scott Voynich has appointed a task force to study the issue of financial reporting for privately-held businesses.
- Former AICPA Chairman Jim Castellano chair's the task force.
- The Task Force mission is to: Determine whether or not general purpose financial statements of private, for-profit entities, prepared in accordance with generally accepted accounting principles (GAAP), meet the needs of all constituents of that reporting. A related question is whether or not the cost of providing all that is required in GAAP financial statements is justified by the related benefits to private company constituents.
- The members of the task force include highly-respected and qualified representatives from various stakeholders in the private company marketplace, including user groups, preparers, standard setters and practitioners.

Why Now?

- This is an issue that many of us in the AICPA leadership have heard about from members both in person and in writing.
- The majority of members work in the private company environment. The discussion has come up often over the years under various names.
- However, some concerns that have long been bubbling up are coming to the fore in the post-Sarbanes-Oxley environment.
- There is some frustration with the relevance of the current body of GAAP literature to smaller private businesses.
- Some say lenders don't appear to be using all of the information required in GAAP financial statements.
- The benefits of certain reporting and disclosures in the "non-issuer" environment aren't clear.
- Members are very aware that FASB has some very heavy responsibilities to deal with issues in the post-Enron public company environment and that they are now essentially financed by the SEC registrant community.
- And let me add that most members understand and agree that this is the way it needs to be and are very supportive of FASB in this regard.
- They also see FASB supporting a movement towards convergence with international standards and becoming more inclined toward fair value accounting than they have in the past.
- Again, these are not necessarily seen as bad trends.
- But there are some concerns being expressed that small businesses and the CPAs that serve them may not get the appropriate attention in this new environment.

PRIVATE COMPANY FINANCIAL REPORTING

- Some recent FASB standards like SFAS 150 have been pointed out as examples of how the concerns of closely-held businesses are not being adequately addressed.

Status of Engaging Stakeholders

- The Task Force surveyed about 3,700 stakeholders of private company financial reporting under GAAP. The breakdown is as follows.

Random Telephone

- 300 external users (split evenly between investors, lenders, and sureties)
- 300 business owners and financial managers (split evenly between revenue categories of less than $5 million, $5-$25 million, and over $25 million)
- 400 public accounting practitioners (split evenly between four firm category sizes)

Broad Outreach (online, non-statistical survey)

- 353 external users
- 912 business owners and financial managers
- 1298 public accounting practitioners
- 142 “other” interested stakeholders
- The Task Force is awaiting the final survey results from the independent market research firm that helped conduct the survey, and it will evaluate the survey responses in the near future and issue its findings and recommendations (if any) in a forthcoming report.
- The Task Force expects to report any findings and recommendations to the Board by the end of this calendar year.
- The Board believes that the profession needs to take the lead on defining any issues on this topic, and not wait for the standards setters and regulators.

THE COMPUTER-BASED UNIFORM CPA EXAMINATION

- The Uniform CPA Examination has been transitioned to a computer-based test (CBT). The last paper-based CPA Exam was given in November 2003; CBT was launched on April 5, 2004.
- The computer-based CPA Examination will be offered year-round (candidates can test two out of every three months). Using Prometric's test center network, there will be more than 300 test sites nationwide.
- Roles of the AICPA and State Boards remain largely the same. The AICPA creates and grades the exam and state boards have authority over education and experience requirements for licensure within their jurisdictions.
- Along with the computer-based delivery method, the examination's content has been revised based on recent practice analysis findings. The revised exam incorporates increased emphasis on information technology and general business knowledge with a broadened scope in the audit area, and increased skills testing.
- The revised CPA Examination has greater fidelity to accounting practice and will better protect the public interest by focusing more on entry-level accounting skills and less on memorization.
- The revised exam has a total length of 14 hours and four sections: Auditing & Attestation; Financial Accounting & Reporting; Regulation; and Business Environment and Concepts.
- Business Environment & Concepts (BEC), an almost totally new section, covers knowledge of general business environment and business concepts.
- Each section of the revised examination, with the exception of BEC, will also contain a new component called simulations. Simulations are relational case studies that will test candidates' accounting knowledge and skills using real life work-related situations. BEC simulations will be included some time after CBT launch.
- Each simulation is approximately 20-40 minutes in length and will complement the multiple-choice portion of the examination. Written communication skills will be tested within the simulations.
- Most simulations will contain some research activity, usually involving an electronic search or access to accounting and auditing authoritative literature, Treasury Code and Income Tax Regulations.
- A tutorial for the computer-based CPA Examination has been developed. The tutorial is available to the public via the new CPA Exam Web site, www.cpa-exam.org and CD-ROM. The Web site is the best place to get the most up to date information.

THE COMPUTER-BASED UNIFORM CPA EXAMINATION

- Proposed granting of credit policy recommendations includes allowing candidates to take examination sections individually and in any order. Credit for passed sections will be retained for 18 months, with no minimum score required for failed sections. Failed sections cannot be taken in the same exam “window” (three month period). State boards have expressed support for these recommendations.
- Candidates who have earned conditional credits on the paper-based Uniform CPA Examination as of CBT launch will be given credits for the corresponding sections of the computer-based CPA Examination and be allowed a transition period to pass any remaining sections. Candidates will have the same time period or number of attempts earned under the paper-based test to pass the remaining sections under CBT.

CPA AMBASSADOR PROGRAM

Overview

- The CPA Ambassador program is designed to engage and mobilize CPAs as highly trained and influential spokespeople for the contributions, expertise, and integrity of the Certified Public Accountant.
- Over the past two years, the national media has covered every corporate failure and accounting irregularity with great zeal. But few have acknowledged the hard, honest contributions of the hundreds of thousands of CPAs who conduct themselves every day in accordance with the values that distinguish this profession.
- The CPA Ambassador Programs aims to focus attention on the untold story and value of our profession, one community at a time.
- Our goal is simple: to engage the talents of CPAs to help earn the good men and women of this profession their due.
- By harnessing the passions, intelligence, and insights of CPAs around the country, we hope to drive community and business leaders, employers, legislators, and others to a fuller recognition and appreciation of the enduring value of the CPA.
- In their community outreach, CPA Ambassadors can promote the profession's depth of financial knowledge, underscore the AICPA and state societies' effectiveness as advocates for the public interest, and refocus the spotlight on the profession so that it shines on the value and values of the CPA.

How is the Program Structured?

- The AICPA and the state CPA societies are working in close cooperation on this program which offers our members access to top-quality spokesperson training, as well as extensive background tools.
- Each CPA who participates in the program will be trained on four critical message quadrants that will help reintroduce the CPA profession to the American public: Restoring Confidence (in financial markets and the profession), Financial Literacy (for the public), Recruitment (of the next generation of the profession) and the Small Business (CPA Relationship).
- Support tools include prepared speeches, key messages and talking points, guidance on handling tough media questions, and briefings on issues that dominate today's headlines. Materials are distributed to participants and are available on www.cpaambassador.org. CPAs will also have the opportunity to emphasize the CPA profession's commitment to battling fraud, improving auditing standards and quality, and shoring up small businesses which represent the main economic engine of this country.
- The CPA volunteers who step up for the CPA Ambassador Program are the most essential asset of the profession's grassroots reputation-building campaign.
- Accordingly, their contributions are recognized. After participation in the training program, CPAs earn a special CPA Ambassador pin and have their names and placements cited on a newly designed section of AICPA.org, www.cpaambassador.org.

- As the program develops, we will develop new, exciting ways to further acknowledge the great contributions these CPAs are making to their communities and to the profession.
- As of October 6, 2004, 229 members in 32 states have been trained as CPA Ambassadors.

Conclusion

- We have reached an exciting juncture in the evolution of the CPA profession. Emerging from the challenges of the past two years are extraordinary opportunities for communicating why CPAs are the most trusted advisors to businesses and individuals.
- Those willing to step up to the CPA Ambassador Program are choosing to help us take on the job of reminding America that America still counts on CPAs.

CPA STUDENT RECRUITMENT CAMPAIGN

- The objectives of the five–year ***Start Here. Go Places.*** CPA Student Recruitment Campaign are threefold:
  - Build awareness and understanding about the CPA profession among high school and college students
  - Change perceptions regarding the CPA profession
  - Increase the number of students majoring in accounting and ultimately pursuing CPA certification
- Our focus in the first 18 - 24 months of the campaign was to publicize and encourage as many students as possible to make multiple visits to ***StartHere.GoPlaces.com.***
- The campaign continues to communicate with late high school and college students about the world of business and accounting and through that lens, the myriad opportunities and experiences available by majoring in accounting and pursuing CPA certification.
- During Year 3, our primary objective shifted to keeping the students involved with the program. This shift was a result of a significant number of leads – visitors to the site.
- Our campaign objectives, therefore, matured to better address the needs of the students and "migrate" them closer to pursuing accounting and later CPA certification.
- The third year of the five-year, $25 million direct marketing effort aimed at 16-22 year olds ("Generation Y") was launched in October 2003 with the "**Catch Me If You Can" Forensic Accounting Game/Contest** and the **"Money Means Business" Online Workshop** promotions for college and high school students, respectively.
- Objectives of the promotions were four-fold:
  - Encourage student involvement
  - Expose students to all levels of a business, demonstrate to them and allow them to experience how accounting plays a role everywhere
  - Afford students an opportunity to apply their skills in a real world business application through all of the various scenarios that may occur as they increase in difficulty and intensity
  - Inspire students to consider a course of study or career path they may not have considered before
- We used successful channels to build awareness, drive traffic to StartHereGoPlaces.com, and get more students committed to pursuing accounting.
  - Direct Mail
  - E-mail and E-Newsletters
  - Posters, newspapers, bookmarks
  - Web site sponsorships, search engine marketing, advertising

CPA STUDENT RECRUITMENT CAMPAIGN

Results as of September 2004:

- More than 750,000 unique responders
- More than 165,000 registrants
- More than 138,000 leads

- As in prior years, we reached students with varied interests. In addition to attracting students already on the accounting track, we were able to cast a much wider net by creating involvement among those with other majors and interests.

New Messaging in the Coming Year

- Objectives for Year 4 of the campaign (August 2004 through July 2005) continue to focus primarily on migration – to the pursuit of accounting and CPA certification - of current students in the ***SHGP*** program as well as continuing to fill the pipeline with new students.
- As a result of qualitative research conducted with students this year, we have gained new insight into the messages that influence students' decisions in pursuing accounting. We are continuing with the overall messaging strategy from past years but refining it to include the following key attributes of accounting that resonate with students:

Accounting is:

About team work

It's about independent contributions that help the team succeed

Entrepreneurial

It's about being in control, independent and stable

Creative

The more problems you solve, the more valued you are

About integrity

A strong code of ethics

- As always, how we get our message across is critical. Using the new insight we gained from the students, our communications in coming months will be infused with messaging that asks them to:

Rise to the occasion

Take the scholastic and professional challenge; solve the puzzle.

Take charge of your own accomplishments

We will highlight the multiple pathways and opportunities that support the choice of majoring in accounting and pursuing CPA certification.

Have control and independence

By majoring in accounting and pursuing CPA certification you have the power to choose your own career path with job and financial security.

Never stop growing

With ongoing learning and a life-long sense of achievement.

Value the certificate that signals expertise

Students recognize the value of earning CPA certification and they prize the expert status bestowed by the achievement.

- All of these attributes will be carried throughout the campaign in the coming months through the communications media.

CPA2BIZ

Opening Statement

- CPA2Biz is a separate privately-held company, of which the AICPA is a major shareholder.
- CPA2Biz has a two-fold charter for its business which is based on the original vision for CPA2Biz:
  - To develop an online CPA channel and provide marketing & technology services to the AICPA and other 3rd parties.
  - To strengthen the relationship between CPAs and their clients by providing products and services to CPAs that they could offer or refer to their clients.

A Bit of History

- In early 2000, the AICPA concluded, that as a non-profit dues-based organization, it lacked sufficient resources to build the type of technology platform necessary to effectively provide Internet-based solutions that add value for its members. Realizing this critical need, the AICPA, with the approval of its governing Council, created CPA2Biz. The new entity was created to provide value-added solutions to our members, and to serve as our primary marketing and distribution organization.
- CPA2Biz was able to raise outside capital (Microsoft, Thomson etc.) for purposes of building the technology platform and for developing a new business area - providing business solutions (e.g. payroll, banking) to enable CPAs to build stronger relationships with their clients.

AICPA/CPA2Biz Relationship

- We remain an important investor in a company that serves us as a distributor of information and services to our members.
- The AICPA does not fund or have any commitment to fund CPA2Biz.
- Under an updated CPA2Biz contract, the AICPA currently pays commissions to C2B at market rates for technology services and marketing in the same way we would pay other companies to whom we outsource functions. *Also, p*lease note that the original CPA2Biz contract was favorable to the AICPA and sheltered the AICPA from the downturn in the economy and the effects of the 9/11 crisis.
- Through CPA2Biz, the AICPA has avoided the direct cost of developing an online marketing and sales platform.
- Please note even though C2B sustained significant losses during the first 2 1/2 years of operations; in late 2002, a new management team was formed, led by their new CEO, Erik Asgeirsson. The new team restructured C2B's revenue model and realigned the business plan. Based on these changes, C2B's net loss was reduced

90.5% from $33.8 million in 2002 to $3.2 million in 2003. In addition, CPA2Biz has attained a new milestone. In its most recent fiscal year (FY2004), CPA2Biz had positive cash flow from operations as well as overall positive net cash flow. This represents significant progress from prior years, and is a result of the marketing and operational investments that have made CPA2Biz a valuable asset to the CPA community.

- At the inception of CPA2Biz, certain members of the AICPA staff acquired stock for fair value. Each of them later decided to donate their stock to the AICPA Foundation and no AICPA staff officer has stock options or any other ownership.
- From its start, CPA2Biz has been contractually obligated to focus its efforts on providing services to CPAs *and* through CPAs rather than directly to small business. This restriction ensures that CPA2Biz will not try to take control of the CPA's client.

Where is CPA2Biz Now

- The Web site is now used by over 50% of the accounting profession, with over 200,000 registered users. Over the past few years, CPA2Biz has released several site enhancements, which have included a new search engine, improved site navigation, new registration process, new online products such as the integration of the FASB's standards into Resource Online, and the addition of 100's of new products.
- In a Spring 2003 survey to over 5,000 customers, 93% stated that they would recommend the site to their colleague and rated the site either excellent or satisfactory.
- The site has achieved steady growth in both users and online revenue throughout 2004.
- www.CPA2Biz.com now has over 200,000 registered users, serving as a key resource for over 50% of the CPA profession.
- They are now averaging over $200 K in weekly online sales.
- Nearly 50,000 site searches are conducted on average each month, on topics such as COSO, ethics, SAS 99 and CPE.
- CPA2Biz also recently released new site enhancements, including a new capability in the online store to show real-time data on the most popular products customers have purchased, allowing AICPA members to quickly see what professional tools their peers are relying on, and what new editions have been released. Another enhancement, the site search engine now highlights the most relevant articles and products for customers.
- The growth of this online channel is very encouraging from an AICPA perspective. It has helped to build new revenue lines for the AICPA and helps us increase member satisfaction and retention.

- CPA2Biz also provides marketing services for AICPA products and services through a number of industry-leading print communications vehicles that it produces. These CPA2Biz marketing vehicles include: flagship annual accounting catalogs, specialty brochures and newsletters, and advertising in leading accounting publications. CPA2Biz leverages best practices in creative strategy, target marketing and customer market research to produce several hundred direct mail and email marketing communications annually.
- CPA2Biz also develops client-focused Business Solutions programs, such as the Paychex Partner Program (payroll) and Chase CPA Advantage Program (banking). The Business Solutions side of CPA2Biz will also help CPA2Biz grow while offering our members new opportunities.
- Just ten months after the launch of these initiatives, over 10,000 CPA firms nationwide are currently participating in the Business Solutions Program with over 1,000 new firms signing up each month. With built-in benefits for CPAs and their clients, these programs bring large-firm resources to all firms. CPA2Biz continues to execute against a core operating objective – encouraging long-term client loyalty by delivering unique value to and through CPAs.
- Through the Paychex Partner Program, participating CPAs can offer their clients one month of free payroll processing and a six-month satisfaction guarantee. In addition, CPA2Biz and Paychex have put procedures in place to assure the CPA remains the client's main contact at all times.
- CPA2Biz has also teamed with Chase this year to rollout the CPA Advantage Program. This small business banking program offers CPAs a dedicated hotline, direct access to client financial information, a special small-business account manager to work with, and preferred pricing for the firm and its clients.

Financial Highlights

- After two years of improving financial performance, CPA2Biz has attained a new milestone. In its most recent fiscal year, CPA2Biz had positive cash flow from operations as well as overall positive net cash flow. This represents significant progress from prior years, and is a result of the marketing and operational investments that have made CPA2Biz a valuable asset to the CPA community.

In conclusion

- CPA2Biz has successfully created a leading online CPA channel for the AICPA that is being used by more and more satisfied customers/AICPA members.

CPA2BIZ

- CPA2Biz has demonstrated the growth, value and success of the Business Solutions Program, which now has over 10,000 firms enrolled. The Business Solutions Program enables AICPA members to build stronger relationships with their clients.
- Due to overall business improvements, CPA2Biz is now able to financially support its future operations

SHARED SERVICES LLC and MSP

- In late 1999, several State CPA Society and American Institute of CPA (AICPA) representatives developed the concept of a "shared services" organization. Collectively, the State CPA Societies and AICPA began to work together on this unique partnership that became the Shared Services Limited Liability Corporation (SSLLC), as incorporated in May 2000.
- SSLLC is a 50/50, joint venture of the AICPA and the State Societies Network Incorporated (SSNI). SSNI is a separate non-profit legal entity, the members of which are the 50 State CPA Societies plus Washington D.C. and Puerto Rico.
- The initial SSLLC project is to coordinate the design, development and deployment of a fully integrated membership database – the Member Solutions Partnership (MSP). Additionally, SSLLC is negotiating agreements that allow the State CPA Societies and the AICPA to reduce aggregate operating costs by securing savings on purchases by leveraging the collective buying power of its stakeholders.

Member Solutions Partnership (MSP)

- The overall goal for MSP is to create and upgrade business systems (both technology and processes) that will allow us to better serve our collective members. MSP will help streamline business processes, thus allowing for more efficient ways to do business. As a result, we will operate with more accurate information about members, allowing for more informed management decisions, and ultimately providing enhanced services to our collective membership.
- The MSP project encompasses the development and deployment of functionality for enterprise resource planning (ERP), association and customer/member relationship management (CRM) features and human resource management (HRMS). The Oracle solution is a comprehensive, integrated solution based on the consolidated requirements created by the AICPA and the State CPA Societies.
- The AICPA, The Ohio Society and the Indiana Society have implemented the initial rollout of the MSP, and Shared Services is deploying the next wave of states (Maryland, Louisiana and Delaware) in the fourth quarter 2004. Opportunities for additional state societies to begin adoption will continue over the next few years, based on the state societies' schedules for implementation.
- As with any project of this magnitude, the deliverable dates are subject to change. SSLLC is committed to keeping everyone apprised as the project progresses.

SHARED SERVICES LLC and MSP

Operations Cost-Savings and Volume Discounts Through Strategic Sourcing

- Future efforts of SSLLC are focusing on agreements allowing the AICPA and the State CPA Societies to reduce aggregate operating costs and secure savings on volume purchases. Here's some information on a couple of these projects that are underway:
    - The first strategic sourcing offered through the procurement system is office supplies from Office Depot. To start the program, SSLLC pulled together an initial list of the 150 most common supplies ordered by the states and the Institute and have negotiated deep discounts with Office Depot on these items. This list of 150 items will be continuously updated based on volume purchasing. These 150 highest volume items have a negotiated discount ranging from 12 – 50% from published Office Depot prices.
    - Also, SSLLC offers a new printing services program through Kinko's, which replaced the printing program offered for printing AICPA/PDI group study materials.
    - The Kinko's program expanded the existing AICPA printing contract concept to include all of state society's printing needs.
    - States can upload an unlimited number of documents to the Kinko's Web site and have them printed. And Kinko's offers competitive advantage rates on black and white printing, color printing, reduced or no shipping charges, and walk-in location discounts.
- SSLLC has created a Strategic Sourcing Task Force that is continually searching for and evaluating other cost-saving programs to benefit state societies, the AICPA and all members.
- Brent Johnson, the COO of SSLLC and his team are always available to answer your questions on any of these efforts. Brent's e-mail address is bjohnson@sharedservicesllc.com.

AICPA SPECIALTY CREDENTIALS

- The Institute currently supports three specialty credential programs: Personal Financial Specialist (PFS); Accredited in Business Valuation (ABV); and Certified Information Technology Professional (CITP)
- The Institute's support for these credentials was reaffirmed by a resolution passed at the Fall 2003 meeting of AICPA Council.
- The resolution also reaffirmed the Institute's commitment to supporting members engaged in the specialty disciplines of business valuations, personal financial planning and information technology.
- As part of that commitment we also are making efforts to strengthen the Institute's membership sections in these specialty areas.
- The resolution called for the credential programs to meet certain financial and membership targets within the next several years as a condition for continued support.
- Council also agreed with the Board's determination that retention strategies should not include a national branding campaign because of the costs and effort required to achieve that level of recognition. Instead, the AICPA will develop marketing tools to help credential holders promote the designations in their local markets.
- Council's approval of this resolution came after an eight month period of fact finding, analysis and above all extensive input from our members.
- This input came throughout the period spanning our two 2003 Council meetings and included a variety of vehicles including surveys, telephonic town hall meetings and responses to Invitations to Comment.
- Council members and members of AICPA committees with an interest in these specialty areas were a major part of the deliberative process that led to the ultimate Council resolution.
- A comprehensive two-way communication effort was also maintained with credential holders throughout the process. Additional communications were also developed to connect with specialty section members and the general membership at various points in the effort.

AUDIT QUALITY CENTERS

- Within the past year, the AICPA has created three separate centers to focus on audit quality in three distinct environments – audits of publicly held companies, governmental or “Yellow Book” audits, and audits of employee benefit plans.
- Each center is designed to provide a focal point for practitioners to gain access to specialized information and practical tools.
- They are designed to create a community of professionals committed to excellence – a community that can share experiences and best practices. That may be the most important benefit – the opportunity for dedicated CPAs to learn from and inspire each other.
- In each of the centers, firm membership is voluntary, with member firms demonstrating their commitment to quality by signing on. Each is Web-centric, delivering access to valuable resources online.
- But the centers are much more than just Web sites. They provide a yardstick for professionals to measure their own performance, a constantly-expanding resource library to draw upon, and a bully pulpit to reiterate values fundamental to auditing.
- We believe that the establishment of these centers will improve the quality of audits of public companies, governmental institutions, and employee benefit programs, and will make a powerful statement to members of our profession about expectations for performing quality audits.

Center for Public Company Audit Firms

- The first audit quality center we established was the Center for Public Company Audit Firms, which is fundamentally a restructuring of the SEC Practice Section. SECPS member firms will largely make up the now-voluntary CPCAF, which opened for business on January 1st of this year.
- In the aftermath of Sarbanes-Oxley Act and the establishment of the PCAOB, there have been a significant number of changes that need to be understood and absorbed by everyone involved in the financial reporting process.
- The purpose of the Center for Public Company Audit Firms is to help CPAs involved in public company audits by being a sounding board to interpret these new requirements.
- In addition to providing up-to-date information about regulatory developments, best practices, and technical matters, the Center for Public Company Audit Firms also acts as a liaison to the SEC and PCAOB.

AUDIT QUALITY CENTERS

Employee Benefit Plan Audit Quality Center

- During the past few years the AICPA has taken significant steps to strengthen the quality of employee benefit program audits. Each year more than 5,000 CPA firms audit the financial statements of about 80,000 employee benefit plans subject to ERISA.
- All CPA firms in the United States which audit employee benefit plans are being urged to join the new Employee Benefit Plan Audit Quality Center. In the short time since its launch in March 2004, over 670 firms have already enrolled.
- The Center provides its members with regular updates on current issues and trends, a single voice in representing the interests of employee benefit plan auditors, and a comprehensive set of resources to help firms establish best practices that will ensure the quality of EBP audits.
- Membership in the Center will send a powerful statement about our profession's commitment to excellence in this area.

Governmental Audit Quality Center

- The Governmental Audit Quality Center, which will be launched this fall, will give auditors of government audits, including Yellow Book audits done under GAO government auditing standards, its own resource center.
- More than anything else, all three audit quality centers are a reiteration of the commitment of our profession to provide advice that can be trusted. They are also a sign of our profession's commitment to willingly and thoughtfully raise the bar on our *own* expectations, in the pursuit of excellence.

CENTER FOR PUBLIC COMPANY AUDIT FIRMS

- Commenced operations on January 1, 2004 as a voluntary membership organization for firms that audit or are interested in auditing public companies
- Primary objectives and programs of the Center include:
    - Establishing the Center as the "voice of the profession"
    - Providing a forum for member firms to discuss and express their views on matters that impact the audits of public companies
    - Enhancing the quality of member firms' public company audit practice through, for example, timely communication of regulatory developments, development of best practices guidance and technical updates
    - Maintaining relationships with and acting as liaison with the PCAOB and SEC on behalf of member firms
    - Preparing and issuing comment letters on rule proposals that impact auditors of public companies jointly with other AICPA senior committees
    - Serving as a resource in identifying solutions to auditing, inspection and other issues identified by the regulators
    - Administering a peer review program that focuses on member firms' private company audit practices and will co-exist with the PCAOB's inspection of member firms' public company audit practices
- Governed by an Executive Committee having senior status (permanent seats + 7 non-permanent seats)
- Center Membership requirements
    - All audit partners residing in the United States and eligible for AICPA membership must be AICPA members
    - Public file for annual report and peer review report
    - Pay Center dues
    - If subject to the Center's peer review program, pay administrative fees related to peer review and comply with the requirements of and actions directed by the peer review committee
- Center membership is voluntary, but membership is encouraged if undergoing a Center peer review

AUDITING STANDARDS BOARD RESTRUCTURING

- The new ASB is committed to working closely with the PCAOB, the state boards of accountancy, other regulators and the users of non-issuer financial statements with the goal of developing auditing standards for non-public entities.
- State boards have long looked to the AICPA to establish standards of behavior and practice for the profession. The laws of a substantial majority of states specifically point to AICPA auditing standards as the measure by which auditors of financial statements are judged.
- Members of the user community and state boards will participate as members of the ASB, which will exchange information and ideas with all stakeholders in the process, including the PCAOB.
- Congress and the SEC wrote Sarbanes-Oxley and the implementing rules with public companies in mind. The PCAOB is carrying out its responsibilities to set auditing standards for the issuer, public company environment.
- Private company financial reporting needs and concerns are very different from public companies. These may well require differences in the establishment of standards for the conduct of private company audits
- NASBA has recently re-affirmed the AICPA's obligation to update and revise auditing standards for audits of private companies/non-issuers by endorsing language to that effect in the revised Uniform Accountancy Act.
- Users of financial statements stand to benefit from the open and cooperative environment in which the new ASB will operate. Representatives of the user community and state boards will participate as members of the ASB, which will exchange information and ideas with all stakeholders in the process, including the PCAOB.
- AICPA members who perform audits of non-issuers, private companies will continue to benefit from the guidance provided by the ASB.
- The subject of differential auditing standards was discussed over the course of several meetings of the AICPA Council, most recently the Fall of 2003 during which a resolution was passed approving the participation of non-members on the ASB.

OUTSOURCING OF CPA SERVICES

- Concerns have been raised regarding CPAs and other professionals who involve third-parties in the services that they deliver to clients.
- The use of third-parties as part of the provision of client services is neither something new nor is it unique to the CPA profession.
- Members of the American Institute of CPAs are held to a very high standard if and when they do outsource services to ensure that the interests of the client and the public are protected.
- Members are responsible for ensuring the accuracy and completeness of the services rendered by the third-party provider and for maintaining the security and confidentiality of client information.
- There are a variety of reasons that some CPA firms may choose to outsource certain components of their work for a client. The general result is some cost savings or efficiency, which can be passed along to clients or free up firm resources to provide more strategic higher level services for their clients.
- While members are not currently required (either by the Code of Conduct or Federal regulations) to advise clients regarding their use of a third-party provider, members have always been required to be forthright in response to client's inquiries on the subject.

New Proposed Ethics Rulings

- After a healthy debate on the issue, the AICPA's Professional Ethics Executive Committee has proposed one revised and two new ethics rulings that would require such disclosure to clients in certain instances, would require that the member enter into a contractual agreement with the third party to maintain the confidentiality of the client's information and would also clarify other requirements for Institute members.
- The exposure draft, "Omnibus Proposal of Ethics Division Interpretations and Rulings," is available on the AICPA Web site at http://www.aicpa.org/members/div/ethics/ed_outsourcing.htm.
- AICPA members and other interested parties may submit comments until October 8, 2004.
- The Professional Ethics Executive Committee will consider all comments and adopt a final standard at its October 28-29, 2004 meeting in Orlando, FL.

OUTSOURCING OF CPA SERVICES

- The exposure draft proposes three new rulings in the Institute's Code of Professional Conduct:

    - Under Rule 102, Integrity and Objectivity, a member would have to inform the client of the use of a third-party service provider prior to sharing confidential client information with that provider. This applies regardless of the location of the service provider (domestic or foreign), and applies when the member (or his/her firm) neither controls (entity) nor employs (individual) the provider.
    - Under Rules 201, General Standards, and 202, Compliance With Standards, a member using a third-party provider is responsible for all work performed by the provider.
    - Under Rule 301, Confidential Client Information, a member who uses a third-party provider should enter into a contractual agreement with that provider to ensure the confidentiality of client records.

- The CPA profession has for over 30 years had a very high set of standards in place for its members to adhere to if they choose to outsource some activities.

- The Institute's long-standing policy with regard to outsourcing has been that our members are ultimately responsible for the quality of any work performed by a third-party provider.

- We believe this new proposal only strengthens those standards and by passing it, our members will further demonstrate their commitment to our profession's core values of integrity, competence and objectivity.

TASK FORCE ON ROLE & RESPONSIBILITY OF COUNCIL

- AICPA Chairman William Ezzell appointed the Task Force in February 2003. The Task Force was given charge to evaluate manner in which representation on Council was determined and in which Council conducts its activities. The Task Force was directed to give special consideration to communications and the relationship of the Council with the membership at large and with the Board of Directors.
- The Task Force was composed of members from the various member segments; from members who were current and past members of Council, plus members who were active in the profession, but never served on Council and one chief staff executive of a state CPA society.
- The Chairman asked the Task Force to include, but not limit its considerations, to: (1) the current method by which Council members are elected/appointed by the states and the Council itself, (2) the current means by which members of Council are kept informed, (3) whether Council members should function as advocates/representatives of the members or act as trustees of the profession as a whole, (4) whether Council members should function as representatives of their particular state or should be encouraged to represent their own views with respect to matters under consideration, (5) how Council members can stay informed about their constituents' views and (6) ways to facilitate and enhance communication between Council, the Board of Directors, the state societies' leadership and the grassroots membership.
- The Task Force issued its initial report to the members of Council in the Fall of 2003. This report was discussed by the members of Council at its Fall 2003 meeting. The Task Force took this input and issued its final report in February 2004. This report was discussed and considered by the members of Council at its regional and regular meetings in March and May 2004.
- The Task Force Report included 14 recommendations, which fell under the following general categories: Council Members' Role and Responsibilities; Nomination and Election of Council Members; Orientation/Preparation of Council Members; Council Meetings/Format/Protocols; Improved Communication Initiatives and Council Member Terms.

TASK FORCE ON ROLE & RESPONSIBILITY OF COUNCIL

At its May 2004 meeting, the Council approved the following four Task Force recommendations:

1) That Council reaffirms its role as leaders and trustees of the profession. As part of this recommendation, Council and Board members were asked to sign a “Statement of Responsibilities” (Appendix A) upon accepting their positions.
2) That after Council has acted on a specific issue; the members of Council have an obligation to present the position of Council as well as the pros and cons of the issue. In addition, members of Council should feel free to express their personal views on the matter.
3) Council should adopt a resolution urging the state societies to use a democratic process in selecting their Council representatives by actively soliciting nominations and (1) requiring the approval of the society’s Board of Directors or (2) an election by the membership using the processes similar to those used in electing society officers.
4) Each meeting of Council should have an Open Forum, which any member of the AICPA will have the opportunity to voice their views.

At its April 2004 meeting, the AICPA Board of Directors agreed to take responsibility for implementing the following:

1) The Board of Directors should investigate ways to provide members of Council with more timely information on the issues under discussion and provide more pro and con perspectives on the issues.
2) That a mechanism should be established so that Council members can be called upon to consider, and suggest, items for the Board of Directors and Council agendas in advance of the meetings.
3) That Council should provide more extensive training for its members, most notably by enhancing the New Council Member Orientation program.
4) That breakout session, electronic polling and other participatory activities should be a regular part of Council proceedings as appropriate.
5) The AICPA should explore ways to solicit the views of Council members between meetings, including conference calls, web casts, electronic polling and voting.
6) That the Issues Briefing papers should be distributed regularly to members of Council.

INTERPRETATION 101-3 – PERFORMANCE OF NONATTEST SERVICES

- Revisions to the AICPA Code of Conduct that apply when nonattest services are provided to attest clients became effective on Dec. 31, 2003.
- Some have accused the AICPA of "cascading" Sarbanes-Oxley independence rules to private company audits. That is not the case. Process started in 1999 when PEEC decided to modernize the Code. Phase 1 dealt with financial interest and family relationships and result in an engagement team approach to auditor independence. Phase 2 dealt with scope of services.
- The underlying principles remains unchanged: The auditor may not undertake the role of client management, cannot perform management functions or make management decisions on the client's behalf, and cannot audit his or her own work. This has been a longstanding position of the AICPA.
- The client has the responsibility to make all management decisions, including all significant matters of judgment.
- They must also establish and maintain internal controls, evaluate adequacy of services, accept responsibility for the results of the service, and also *designate a competent employee to oversee the service.*
- By ensuring that the client has a competent individual designated to oversee the member's nonattest services and make all management decisions, the threats to independence are sufficiently mitigated because the member's audit procedures would be applied solely to transactions and other matters that reflect the client's decisions, not the member's, thus enabling the member to carry out those procedures with objectivity and an appropriate level of professional skepticism.
- Changes to Interpretation 101-3 were designed to clarify the general requirements of the rule by incorporating an assessment by the member of client competence and a requirement that the member's understanding with the client be documented.
- The prior rules required that management "make an informed judgment on the results of the member's nonattest services". PEEC always interpreted this to mean that management had to be competent in order to make such an informed judgment.

Provisions to address specific types of nonattest services

- The revised 101-3 clarifies some rules regarding bookkeeping and internal audit services.
- It also imposes more restrictive rules on providing other services to attest clients, including valuations, appraisals, actuarial work and information systems design and implementation.

INTERPRETATION 101-3 – PERFORMANCE OF NONATTEST SERVICES

Compliance with more restrictive independence rules

- The revised rule also incorporates an explicit requirement under Rule 101 that members must comply with more restrictive independence rules of other bodies - such as the SEC - where applicable.
- Previously members failing to comply with independence rules of bodies such as state accountancy boards, the SEC, the GAO etc., where those rules were stricter than AICPA rules, could be disciplined but under Rule 501, Acts Discreditable.

Member concerns over level of client "competence"

- Some members, particularly those affiliated with smaller firms, have expressed concerns regarding the practical application of certain general requirements outlined in the Interpretation.
- Of particular concern was whether the level of competence that the designated client employee should possess to be a "competent employee" and effectively oversee the nonattest service should be equivalent to that of the member.
- This is not the case. In meeting the competency requirement, it is not intended that the client employee possess a level of technical expertise commensurate with that of the member.
- Rather, the client employee should understand the nonattest services sufficiently to be able to understand the key issues involved, make any required management decisions and evaluate the adequacy of the resulting work product.
- One resource to assist our member's understanding of this aspect of the revised rule is an article published in the public practice supplements of the April CPA Letter and available online at http://www.aicpa.org/download/cpaltr/2004_04/supps/F-LrgApr.pdf

  AICPA staff is currently working on additional guidance concerning the issue of client competency which should be posted to the AICPA Web site in October 2004.

Documentation of client understanding

- Prior to performing nonattest services, the member should establish and document in writing the understanding with the client, with regards to:
  - The objectives of the engagement
  - The services to be performed
  - The client's acceptance of its responsibilities
  - The member's responsibilities
  - Any limitations of the engagement

INTERPRETATION 101-3 – PERFORMANCE OF NONATTEST SERVICES

- In order to provide members with additional time to update firm policies and procedures and further educate their staff, this documentation requirement has been deferred until December 31, 2004.

Further guidance and clarification

- Members might also wish to read the *Basis for Conclusions* document published by the Professional Ethics Executive Committee after final approval of the rule. This document is posted at: http://www.aicpa.org/members/div/ethics/index/bfc1.htm
- Members looking for guidance on the applicability of the revised rule under certain circumstances might also want to read a newly published set of *Nonattest Services Q & A's* which are online at: http://www.aicpa.org/members/div/ethics/nonattest_q_a.htm

STATE ACCOUNTING REFORMS

The State Cascade

Background on the Cascade Effect

- Even before the passage of the Sarbanes-Oxley Act of 2002, the AICPA expressed concerns that the Federal legislation that had been contemplated by Congress to apply to publicly traded companies could be enacted at the state level, causing a "pile-on."
- The threat of this cascade of activity and the potential harm it could impose to smaller CPA firms and small business was at the forefront of the AICPA's concern.
- While the U.S. Congress attempted to address the issue of the cascade effect at the state level by adding Section 209 of the Act that states, "state regulators are directed to make an independent determination as to whether the Board's standards shall be applied to small and mid-size non-registered accounting firms," the reality is that states are reacting in a different way.

2004 State Legislative Activity

- Fifteen bills were introduced in 5 states whose provisions included: limitations on non-audit services; work paper retention; auditor rotation and stricter government enforcement penalties.
- Seven bills were introduced in 2 states concerning corporate governance reforms.

State Executive Branch/Regulatory Activity

- Not all of the activity has occurred in the state legislative arena, and there has been significant activity at the state executive branch and regulatory level.
- Other state regulatory agencies who proposed reforms:
  - The Indiana Family and Social Services Administration required audit firm rotation every five years.
  - Indiana's Department of Administration has suggested that potential participants in request for proposal (RFP) comply with Sarbanes-Oxley requirements.
  - The Pennsylvania Commission on Crime and Delinquency proposed adopting Sarbanes-Oxley provisions for its agency.
  - Nevada and North Carolina Department of Insurance proposed adopting a seven-year record retention requirement insurer audits.

STATE ACCOUNTING REFORMS

State Attorneys General

- State Attorneys General from NY, CA and MA offered proposals that would apply Sarbanes-Oxley provisions to non-profit organizations.
- Those provisions include: mandatory auditor rotation, limitations on non-audit services, CEO/CFO Certification of financial statements and require non-profit organizations to establish an audit committee.

State Outlook for 2005

- A recent survey of state CPA societies indicates that nearly 20 states believe that activity may occur within their state during 2005.

Ready to Provide Assistance-AICPA Special Committee on State Regulation

- In 2002, a high-level Special Committee was established to provide input to the AICPA and assist states with addressing the state issues and implications associated with the passage of the Sarbanes-Oxley Act.
- The Special Committee developed a compendium of two White Papers (*A Reasoned Approach to Reform* and the *Complexity of the Issue*) and five Issue Briefs (*Audit Partner Rotation, Peer Review, Scope of Services, State Board Composition* and *Professional Ethics*) were developed and incorporated into a document entitled *A Reasoned Approach to Reform.*
- For a copy of *A Reasoned Approach to Reform*, visit: https://knowledgenet.aicpa.org/kn/livelink.exe?func=ll&objId=2196469&objAction=browse&sort=name

ASB, PCAOB AND PRIVATE COMPANY AUDITING STANDARDS

- Publicly held companies are able to access very deep and liquid capital markets.
- For that privilege, public companies agree to higher levels of regulation and public scrutiny, all of which come at a cost.
- Most, if not all, public company shareholders are indirect or passive investors and do not have access to or influence over management. Therefore, they must completely rely on publicly distributed financial information.
- Privately held companies – which by many measures represent more than 50% of the US economy - take other roads to finance their operations.
- It is these companies that spawned Microsoft from a garage, Mrs. Fields from a kitchen and countless other success stories.
- Private company stakeholders have direct access to management and therefore have information that supplements the audited financial statements.
- State accountancy boards have long looked to the AICPA to establish standards of behavior and practice for the profession. The laws of a substantial majority of states specifically point to AICPA auditing standards as the measure by which auditors of financial statements are judged.
- NASBA has recently re-affirmed the AICPA's obligation to update and revise auditing standards for audits of private companies/non-issuers by endorsing language to that effect in the revised Uniform Accountancy Act.
- We take that responsibility very seriously and we have reconstituted the Auditing Standards Board to ensure that constituents of privately-held company financial statements are strongly represented on that body.
- In the U.S. there are three auditing standard setters: The PCAOB for publicly held companies, the ASB for all entities not covered by PCAOB and the GAO who works with the ASB for governmental entities.
- We appreciate the leadership of David Walker in the formation of the Coordinating Forum. In that venue we are working with the PCAOB and the GAO to keep our standards as close as possible. Our mantra is "we will not have differences for difference sake."
- We respect the role of the PCAOB and we are working diligently to ensure that our members who audit publicly held companies and that are employed by publicly held companies have the information, guidance, and tools that they need to implement PCAOB standards.
- We have taken steps to make clear to our members that they must follow applicable PCAOB or GAO standards in order to be in conformity with the AICPA Code of Conduct.
- Likewise, we are working diligently to ensure that our members that audit privately-held companies and work for privately held companies conduct their work in accordance with standards that appropriately meet the needs of users of privately held company financial statements.

FINANCIAL LITERACY

- The CPA profession is deeply concerned about the lack of financial literacy of Americans at all financial levels and is alarmed at the continued decline of savings, retirement planning and the financial preparedness of the American public.
- The profession has responded to this alarming trend by launching the 360 Degrees of Financial Literacy effort, spearheaded by the AICPA, with the support of the state CPA societies. It gives CPAs the tools they need at the local level to volunteer to educate Americans, from school children to retirees, on financial topics that apply to their particular stage of life.
- 360 Degrees of Financial Literacy provides a comprehensive approach to financial education. It sends the message that financial education should be a lifelong endeavor—from a child putting pennies in a bank to helping adults make wise decisions to reach a secure retirement.
- Financial literacy can be defined as the ability to read, analyze, manage and communicate about the personal financial conditions affecting material well-being. It includes the ability to make financial choices, understand money and financial issues, plan for the future and respond to life events.
- The National CPA Financial Literacy Commission is leading the profession's national efforts to advance the financial literacy of Americans. Chaired by Carl R. George, CPA, the commission's primary role is to foster CPA participation in personal finance education and increase public awareness of the need for financial literacy. To fulfill these objectives, the Commission will be reaching out to AICPA committees, nonprofit and governmental organizations to identify opportunities and find ways to maximize resources and outreach.
- CPAs interested in getting involved should first visit the AICPA's new volunteer database. The database provides members with an opportunity to register to participate at both the national and local levels in the financial literacy effort. The State Societies can use the database to view members who have signed up as well as list interested members in the appropriate state. Go to: http://volunteers.aicpa.org/financialliteracy.
- To ensure that the profession's efforts are successful in communities across the United States, the AICPA has gathered the Grassroots Mobilization Team, led by Jimmy Williamson. The team's members are state society executive directors and CPAs who have dedicated themselves to advancing financial literacy. The team is working to identify models for CPA participation and capture best practices. It is also working with the state CPA societies to facilitate and promote CPA volunteerism in local communities.

FINANCIAL LITERACY

- The national 360 Degrees effort does not provide a "one size fits all" approach to financial literacy activities. Rather, it offers an umbrella for states societies to leverage the CPA presence across the country. The state societies are encouraged to use the tag line "360 Degrees of Financial Literacy" and the generic logo that the AICPA has developed for the states.
- The state CPA societies have the opportunity to choose to participate in the effort in a number of ways. States wanting to organize financial literacy activities are encouraged first to assess members' interests and community needs. Each state may have a different answer to this question. For example, one state may focus on working with legislators, while another may concentrate on K-12 programs or on working with seniors, military families, minority communities or low-income families.
- Many state societies have developed, or are in the process of developing, outstanding financial literacy outreach programs. The AICPA has created a matrix of state society programs and contact numbers. Members can receive a copy of this matrix by e-mailing financialliteracy@aicpa.org.
- The state societies are addressing financial literacy in myriad ways. The California Society has developed the Dollars & Sense program focused on providing a wide range of information to consumers, teachers and legislators. The Michigan Association of CPAs has a very successful program with Junior Achievement, reaching thousands of school children each year. The Virginia Society of CPAs is launching a Financial Fitness Day featuring community workshops. The New Hampshire Society is working with the military and reservists while the Utah Society is focusing outreach to legislators.
- One of the goals of the AICPA's financial literacy efforts is to build resources to support the state societies and members in their volunteer efforts. As a first step in this direction, the AICPA Communications Team recently e-mailed a variety of resources for the states, including general financial literacy presentation materials (speech, PowerPoint, talking points, key messages, articles, pitch letter), brochures, logos and information on how to get involved. State society staff or personnel interested in receiving this information should contact Cheryl Reynolds on the Communications Team at creynolds@aicpa.org.
- To educate CPAs about key financial literacy issues, the AICPA is developing a continuing professional education course to be offered free of charge to CPAs. The course will provide an overview of the financial illiteracy problem and cover key topics. It will be available online in October.
- Additional resources for CPAs will be available in the fall. These include tools to help CPAs and the state societies develop and deliver programs focused on personal finance education.
- To recognize CPAs active in volunteering in financial literacy, the AICPA will offer a new certificate honoring their achievement. We hope to present the first certificate at the fall Council meeting.

FINANCIAL LITERACY

- For consumers, the AICPA is developing a new Web site that will furnish financial literacy education tailored to the 360 Degrees of Financial Literacy life stage approach. When the site is mature, consumers will find information they can use to support sound financial decision making at every stage of their lives.
- Realizing that financial literacy is a vast problem, the CPA profession is committed to staying involved for the long term. The 360 Degrees of Financial literacy effort is an ongoing program that will continue to develop resources to empower CPAs to make a difference in the lives of millions of Americans.
- The CPA Ambassador program trains CPAs to be highly influential spokespeople on four subject areas: restoring confidence in the CPA profession, small business success, student recruitment and financial literacy. While the Ambassador program does address financial literacy in its training, it is a separate program from 360 Degrees of Financial Literacy. 360 Degrees is a national effort to mobilize CPAs to improve the financial knowledge of Americans by volunteering in their communities. Ambassador training is not required to volunteer in this effort. For more information on the CPA Ambassador program, visit www.cpaambassador.org or e-mail Janice Maiman at jmaiman@aicpa.org.
- For more information on the 360 Degrees of Financial Literacy effort, visit www.aicpa.org/financialliteracy. Or e-mail financialliteracy@aicpa.org.

LIABILITY FOR "AIDING AND ABETTING"

- Creating new liability for "aiding and abetting" is unnecessary because current law adequately protects investors. Moreover, creating "aiding and abetting" liability would result in harmful consequences, including an increase in frivolous litigation.
- In 1994, the Supreme Court found that Congress did not intend to make third parties liable for securities fraud under an "aiding and abetting" theory. *See Central Bank of Denver v. First Interstate Bank of Denver*, 511 U.S. 164, 191 (1994).
- The Court also noted that "liability for aiders and abettors exacts *costs* that may *disserve the goals*" of § 10(b) of the Securities Exchange Act of 1934. *Central Bank*, 511 U.S. at 188 (emphasis added). As the Supreme Court explained, if "aiding and abetting" liability were created, accountants and other professionals may avoid advising small or struggling businesses for fear that they could be sued if such enterprises failed. Moreover, the Court emphasized that increased costs incurred by professionals because of increased litigation and settlements could be passed on to client companies and, in turn, to the companies' investors.
- Although the statute, as construed in *Central Bank*, precludes "aiding and abetting" liability, it does not exempt secondary actors such as auditors from § 10(b) or Rule 10b-5 liability. To the contrary, the Court cautioned that "any person or entity – including an auditor, lawyer or bank – who employs a manipulative device or makes a material misstatement (or omission) on which a purchaser or seller of securities relies may be liable as a primary violator under 10b-5 . . . ." *Central Bank*, 511 U.S. at 191.
- The statute's restriction on private "aiding and abetting" claims has not precluded private litigants from filing securities fraud claims against secondary actors for violations of § 10(b) and Rule 10b-5. Indeed, the recent wave of post-Enron litigation includes many lawsuits successfully targeting secondary actors.
- The SEC has extended steady pressure to broaden the reach of securities fraud liability to secondary actors. *See* Brief of Amicus Curiae SEC, *Klein v. Boyd*, Nos. 97-1143, 87-1261, 1998 U.S. App. Lexis 2004 (3d Cir. Feb. 12, 1998); *Newby v. Enron*, 235 F. Supp. 2d at 549, 585-91 (S.D. Tex. 2002) (same). In fact, in announcing the settlement of civil charges against J.P. Morgan Chase & Co. and Citigroup, Inc. for their roles in the manipulation of Enron Corp.'s financial statements, SEC Director of Enforcement Stephen M. Cutler, warned that "if you know or have reason to know that you are helping a company mislead its investors, you are in violation of the federal securities laws." In the past, the SEC's call for an expansive application of liability has been accorded deference by courts.

LIABILITY FOR "AIDING AND ABETTING"

- Lower courts have applied *Central Bank* to hold secondary actors accountable for securities fraud. For example, a federal district court, relying heavily upon an amicus brief submitted by the SEC and applying *Central Bank*, recently held that a secondary actor who creates a material misstatement on which an investor relies can be liable as a primary violator under § 10(b), even where the secondary actor's identity is not known by the investor at the time of reliance. *See Newby*, 235 F. Supp. 2d at 581-91. Accordingly, the court denied several motions to dismiss filed by secondary actor-defendants, including auditors, who argued unsuccessfully that the statute's restriction on "aiding and abetting" liability precluded causes of action for securities fraud against them. *See also Klein*, Nos. 97-1143, 87-1261, 1998 U.S. App. Lexis 2004 (finding that a law firm could be liable as a primary violator of securities fraud even though the attorney-defendant did not sign the documents in question and was not known by the investor as a participant in the documents' creation); *Anixter v. Home-Stake Production Co.*, 77 F.3d 1215, 1225 (10th Cir. 1996) (stating that accountants' misrepresentations can be actionable as primary violations under § 10(b) and Rule 10b-5).
- Studies demonstrate that the cost of settling class action lawsuits, including those involving secondary actors, has increased substantially since the mid-1990s. *See* Cornerstone Research, Post-Reform Act Securities Case Settlements, Cases Reported Through December 2002, at 2, *available at* Stanford Law School Securities Class Action Clearinghouse, http://securities.stanford.edu. The total value of cases settled has increased each year since 1995.
- Punishment for secondary actors is not limited to private civil suits. The PSLRA, which was enacted by Congress in 1995 to reduce frivolous and abusive securities lawsuits, adopted a reasoned approach to "aiding and abetting" liability. While the PSLRA does not affect private "aiding and abetting" claims – it leaves the Court's *Central Bank* decision in place – it nonetheless gives the SEC the means to defend investors by prosecuting anyone who "knowingly provides substantial assistance to another person in violation of" the securities laws. 15 U.S.C. § 78t(f). The SEC's prosecutorial powers provide additional deterrence for and punishment of the "aiding and abetting" of securities fraud.
- The creation of "aiding and abetting" liability would undermine the PSLRA and lead to attorney-driven litigation distorted by contingency fees.
- Increased litigation resulting from "aiding and abetting" claims will harm investors, because shareholders themselves are harmed by extortionate litigation. As owners of the defendant companies, shareholders pay the cost of coerced settlements and attorneys' fees. Funds that are used to settle frivolous lawsuits would otherwise be used to create value for investors and consumers.

TAX ISSUES

Tax Shelters

- Over the last several years, the AICPA's Tax Division has been communicating with Congress about various iterations of tax shelter legislation. In the 107th Congress, that legislation was represented by S. 2498 in the Senate and H.R. 5095 in the House. Many versions of that legislation have been introduced in the current 108th Congress, particularly because the Joint Committee on Taxation has determined the codification of the economic substance doctrine would raise a lot of revenue.
- Interest in this legislation has continued into 2004, most notably in the FSC/ETI (international tax) legislation, culminating on May 11, 2004 with the Senate-passed S. 1637, the *Jumpstart Our Business Strength (JOBS) Act*, and on June 17, 2004 with the House-passed H.R. 4520, the *American Jobs Creation Act of 2004.*
- The AICPA has a clear position on abusive transactions—they should be eradicated. They insult the large majority of honest taxpayers and their CPA advisors who strive every day to obey the increasingly complex tax laws.
- The AICPA has worked hard for years to help society effectively separate abuse from appropriate tax planning. We have consistently supported protection of the public interest and prohibitions on the misuse of our tax system. We continue to be actively engaged in proposing and evaluating various legislative and regulatory measures that are designed to identify and prevent taxpayers from undertaking, and tax advisers from rendering advice on, transactions having no purpose other than the reduction of federal income taxes in an abusive manner.
- In June, we wrote the chairmen of the House Ways and Means Committee and the Senate Finance Committee strongly supporting the language designed to curtail abusive tax transactions that is included in H.R. 4520, the *American Jobs Creation Act of 2004*. In that letter we also reiterated our long-standing opposition to the provisions in S. 1637, the *JOBS Act*, that would (1) codify the economic substance doctrine and (2) raise the tax return standard (for both taxpayers and preparers) to "more likely than not" for **all** tax return positions. We believe these provisions are counterproductive and believe stripping them from the bill would provide a sounder basis for tax administrators to move forward productively to curb abuses while retaining taxpayers' respect for our tax system. We firmly believe that both provisions would have long-term, negative effects on both taxpayers and the government.
- In our view, deterrence from and the eventual eradication of abusive transactions are best accomplished through disclosure, higher non-disclosure penalties, clearer standards for opinion letters and reasonable cause penalty relief, aggressive enforcement, and continued evolution of appropriate solutions by an informed judiciary.

TAX ISSUES

S Corporation Reform

- The AICPA offered its suggestions on June 19, 2003 to the House Ways and Means Subcommittee on Select Revenue Measures on ways to further modernize Subchapter S of the Internal Revenue Code. The Institute urged Congress to craft legislation that would recognize and remove the anticompetitive limitations on the growth of existing S corporations. A number of the AICPA's suggestions have been incorporated into tax legislation under active consideration by Congress.

Mandatory Adjustments to Partnership Basis

- The AICPA wrote Congress in February to express its concern about identical provisions included in two bills that the Institute believes would have a negative impact on partnerships of all sizes. The bills would repeal section 754 of the Internal Revenue Code, which has allowed partnerships, since 1954, to elect whether or not to adjust the basis of remaining partnership assets when one asset is distributed or when a partner transfers its interest. The AICPA urged Congress not to require a basis adjustment because the considerable administrative burden of such adjustments warrants limiting their mandatory application to potentially abusive transactions. The AICPA offered suggestions about how to modify the provisions in order to curtail abuse of current law without imposing unnecessary costs and compliance burdens on taxpayers in non-abusive circumstances. The provisions are included in S. 1072, the *Safe, Accountable, Flexible, and Efficient Transportation Equity Act of 2003*, and S. 1637, the *Jumpstart Our Business Strength (JOBS) Act*.

Implications of Sarbanes-Oxley Act for Tax Practitioners

- The Sarbanes-Oxley Act permits auditors to provide a range of services, "including tax services," with the advance approval of the client's audit committee. However, the statute also lists certain services that an auditor may not provide without losing its independence. Included in the list of prohibited services are some valuation services, legal services, and certain "expert services."

- SEC regulations have taken a reasonably liberal approach to recognizing that tax services have been a traditional part of what auditors offer to their clients, and the final rules on independence note that most tax services continue to be appropriately provided by the audit firm. However, some advocacy services (representation of a client in a tax court, for example) fall into the prohibited range. Audit committees are strongly cautioned to view with skepticism an auditor's tax advice on a transaction with no business purpose other than tax minimization. In short, there is ambiguous language in the interpretive regulations that leaves a number of questions unanswered regarding the propriety of specific tax services.
- Pending further development of the law through additional guidance from the SEC or the Public Company Accounting Oversight Board (PCAOB), or through litigation, we may expect some publicly-held companies to take a conservative approach in permitting a full panoply of tax services to be provided by their auditors.

Extension of Filing Deadline for E-Filed Returns

- The Taxpayer Protection and IRS Accountability Act of 2003, which was passed by the House on June 18, 2003 and is now pending in the Senate, includes a provision to extend the filing deadline to April 30 for taxpayers who file electronic returns and electronically pay the balance of their taxes due.
- The AICPA supports the objective of increasing the number of e-filers, but does not support changing the law to extend the electronic-filing deadline. The Institute believes that the IRS can achieve the same incentive by the IRS deferring the processing of electronic payments for two weeks on e-filed returns—this would give the taxpayer the same period of time to use his or her money without creating a separate due date based on the method of filing.

LIBERALIZATION OF OVERTIME RULES UNDER THE FAIR LABOR STANDARDS ACT

- The Fair Labor Standards Act (FLSA) was enacted in 1938 to protect hourly employees and requires employers to pay employees overtime, unless an employee is exempt. Accountants employed by public accounting firms traditionally have been regarded as exempt professionals under the FLSA's exemption for “professional” employees.
- However, over the years U.S. Department of Labor (DOL) interpretations of the traditional application of the exemption have had the effect of inhibiting the employer’s ability to provide employees with greater flexibility. The DOL has said that requiring professional employees to record and charge their time on an hourly basis—a customary practice in fee-for-service businesses—means that they are hourly employees. The courts have ruled that allowing employees to take leave of less than a full day without pay jeopardizes the exempt status for professional employees. The loss of exempt status makes employers liable for all overtime worked for the past two years. Many accounting firms' long-standing arrangements to give employees additional compensation—such as compensation incentives and compensatory leave banks—for extra time worked during tax and audit busy seasons are jeopardized by these developments.
- Last year, a continuing stand-off between Congressional Republicans and Democrats caused the Department of Labor (DOL) to propose liberalizing its overtime rules through administrative rulemaking. Democrats retaliated using the appropriations process to try to block DOL from spending money to implement any changes to the wage and hour law regulations through DOL’s rulemaking process. The Democrats’ effort failed on July 11, 2003, when the House defeated a Democrat-backed amendment to the DOL’s appropriations bill. However, in the Senate on September 10, 2003, Democrats succeeded in passing an amendment similar to the one defeated in the House. On October 2, 2003, the House reversed its position when it passed a nonbinding resolution instructing House conferees to withhold funding from DOL for this rulemaking. By the end of last year Congressional leaders had struck a deal to insert language in the omnibus appropriations bill to allow the DOL to proceed. Congress approved the omnibus reconciliation bill with the FLSA amendment on January 22, 2004 so that hourly, private sector employees could choose between overtime pay and extra time off when they work more than 40 hours in a given week. Despite that, Senate opponents renewed their fight in May and succeeded in having the Senate pass an amendment, attached to a corporate tax reform bill, that would block a final DOL rule implementing the change. The corporate tax bill has not been passed into law,

LIBERALIZATION OF OVERTIME RULES UNDER THE FAIR LABOR STANDARDS ACT

- The new overtime rules took effect on August 23, 2004. However, the battle over overtime rules continues. The House voted on September 9, 2004 to add language to the FY ’05 DOL appropriations bill to block DOL from carrying out its overtime rules. The Senate hasn’t yet voted on the FY ’05 DOL appropriations bill. President Bush threatened to veto the bill if it arrives on his desk with the language blocking the overtime rules.
- The AICPA filed a comment letter in support of the DOL’s proposed changes to the FLSA as a part of its longstanding effort to update the FLSA so that it helps further the goal of workplace flexibility for both employees and employers. The AICPA also wrote all House members urging them to support the employee’s option to choose between overtime pay and extra time off.

GRAMM LEACH BLILEY ACT PRIVACY ISSUES

- The Gramm Leach Bliley Act (GLB) was enacted in 1999. It contained consumer privacy provisions that require “financial institutions” to take certain actions to protect the privacy of non-public personal information of their customers. These actions include giving customers an annual statement concerning the financial institution’s privacy policies, including whether the personal financial information would be given to any third party. GLB used a Federal Reserve Board definition for “financial institution,” which included the provision of financial and tax planning activities by CPAs and attorneys.
- The AICPA worked unsuccessfully for an exemption from the Federal Trade Commission’s (FTC) rule implementing GLB. We argued that since Federal licensure law and the Internal Revenue Code (with regard to Federal tax returns) prohibited the CPA from disclosing a client’s non-public information to third parties, the disclosure requirements were not needed. The FTC rejected our arguments, saying it did not have the legal authority under GLB to issue an exemption. AICPA has worked with Congress to have a bill introduced that would grant such an exemption.
- The American Bar Association (ABA) filed suit against the FTC, arguing that Congress never intended lawyers to be covered by GLB. The Federal District Court found in favor of the ABA this summer, basing its decision on lawyer-client privilege.
- AICPA’s review of that decision, and discussions with the ABA, lead us to believe that although our claim for exemption is not based on lawyer-client privilege, our argument has a good chance of being accepted under the general principles of the opinion.
- The FTC has appealed the District Court decision, and briefs are currently being drafted by the parties. After discussion with the ABA, we decided that strategically it would be best if we did not file an amicus brief in the case. If the appeal upholds the District Court, we believe the FTC will grant CPAs an exemption.

AUDIT COMMITTEE EFFECTIVENESS CENTER

- The Audit Committee Effectiveness Center, a web-based resource center of best practices, guidance and tools, was launched in early December, 2003 to help audit committees respond to the increased demands placed on them and discharge their responsibilities in an efficient and effective manner.
- The ACEC is the most frequently visited site on AICPA.org. The components of the Center are the Audit Committee Toolkit, Audit Committee Matching System, Audit Committee e-Alerts, and a bank of materials containing information for and about audit committees.
- The initial printing of the Audit Committee Toolkit was sponsored by grants from CNA Insurance Company and the AICPA Foundation and was developed for widespread distribution in the public interest.
- At this time approximately 40,000 copies of the Toolkit are in circulation. We are currently seeking sponsorship for additional printing. The toolkit is also available as a free download with permission granted to tailor and customize to fit organization needs.
- The Audit Committee Toolkit includes an Audit Committee Charter Matrix, summaries of key considerations of internal control and fraud, a decision tree for satisfying the SEC requirements for Audit Committee Financial Expert, as well as guidelines for executive sessions, and for evaluation of the internal audit function, external auditors and the audit committee itself.
- The Business and Industry group is currently working on additional tools for Recall and Reissue of Financial Statements, the new COSO Enterprise Risk Management framework, and one for audit committees of companies receiving adverse opinions under Sarbanes-Oxley Section 404.
- The Audit Committee Matching System was designed to facilitate the process of matching the skills and experience of our members with the needs of organizations seeking audit committee members.
- Approximately 2000 of our members have registered on the Matching System and recent activity has been approximately 50 searches per month.

COSO ENTERPRISE RISK MANAGEMENT – Integrated Framework

Overview and Introduction

- In late September of 2004 the Committee of Sponsoring Organizations of the Treadway Commission (COSO) released the Enterprise Risk Management - Integrated Framework that describes the essential components, principles and concepts of enterprise risk management for all organizations, regardless of size.
- With heightened concern and focus on risk management, the Framework provides boards of directors and managements a clear roadmap for identifying risks, avoiding pitfalls, and seizing opportunities to grow stakeholder value.
- Built on the foundation of COSO's Internal Control – Integrated Framework, being used by many American businesses to comply with the Sarbanes-Oxley Act requirements, this new Framework is expected to be widely accepted as the benchmark for dealing with business risk.

Historical Background of COSO and AICPA Involvement

- For those of you who may not know COSO is a voluntary private-sector organization dedicated to improving the quality of financial reporting through business ethics, effective internal controls, and corporate governance. The members of COSO are: the American Institute of Certified Public Accountants, the American Accounting Association, Financial Executives International, the Institute of Management Accountants and The Institute of Internal Auditors.
- The AICPA has been involved with COSO since its inception. In 1985, the AICPA created the National Commission on Fraudulent Financial Reporting. Chaired by James Treadway, former SEC commissioner, the Treadway Commission was charged with identifying factors that let do fraudulent financial reporting and to recommend steps that would reduce its incidence.
- Appointment of the Commission was the brainchild of Ray Groves, who served as chairman of the AICPA board of directors between 1984 and 1985. Ray's motivation came from a belief that much better coordination was needed between internal and external audits.
- In the early 1990's COSO sponsored an extensive study of internal controls that lead to the publication of *Internal Control – Integrated Framework*.
- That document has been widely adopted by the financial community and has become the most recognized framework for guidance on internal controls.

The COSO ERM Framework

- The COSO ERM Framework should not be considered as a replacement to the Internal Control Integrated Framework, which is being widely used by companies to implement Sarbanes Oxley Section 404.
- It does step up and address the critical area of risk management.
- I should reiterate that the COSO *ERM Framework* - like the *Internal Control Framework* - is not just a large company or a public company resource. A small business CFO or a practitioner working private company clients should also find lots of value in this document.
- COSO recognizes that while many organizations may be engaging in some aspects of enterprise risk management, there has been no common base of knowledge and principles to enable boards and senior management to evaluate an organization's approach to risk management and assist them in building effective programs to identify, measure, prioritize and respond to risks.
- The COSO *ERM Framework* provides businesses as well as other organizations, for the first time, with a principles-based framework that will enable them to identify all the aspects that should be present in every company's enterprise risk program and how they can be successfully implemented.
- The Framework speaks to many of the issues currently facing organizations such as how an organization determines the right amount of risk for the value it is striving to create for stakeholders and how it responds to risk to best protect and enhance value
- You can find out more about the COSO ERM Framework on the AICPA website at http://www.aicpa.org/news/2004/2004_0929.htm

XBRL

Background

- XBRL started in 1998 as the idea of a single CPA, Charlie Hoffman, who worked for a small CPA firm in Washington State. He had an idea—one that he was convinced could totally transform business reporting.
- Charlie enlisted the support of the AICPA and together they became the catalysts for launching XBRL. The eXtensible Business Reporting Language, or XBRL, aims to "facilitate transparency in business reporting" and is foundational to the Enhanced Business Reporting Initiative.
- XBRL is recognized in 15 jurisdictions with more than 250 corporate members around the world and that number continues to grow. The European Commission has funded a special 1,000,000-euro XBRL project to encourage adoption and that is having a major impact on awareness and adoption in Europe. Also, the SEC recently launched a voluntary XBRL initiative.

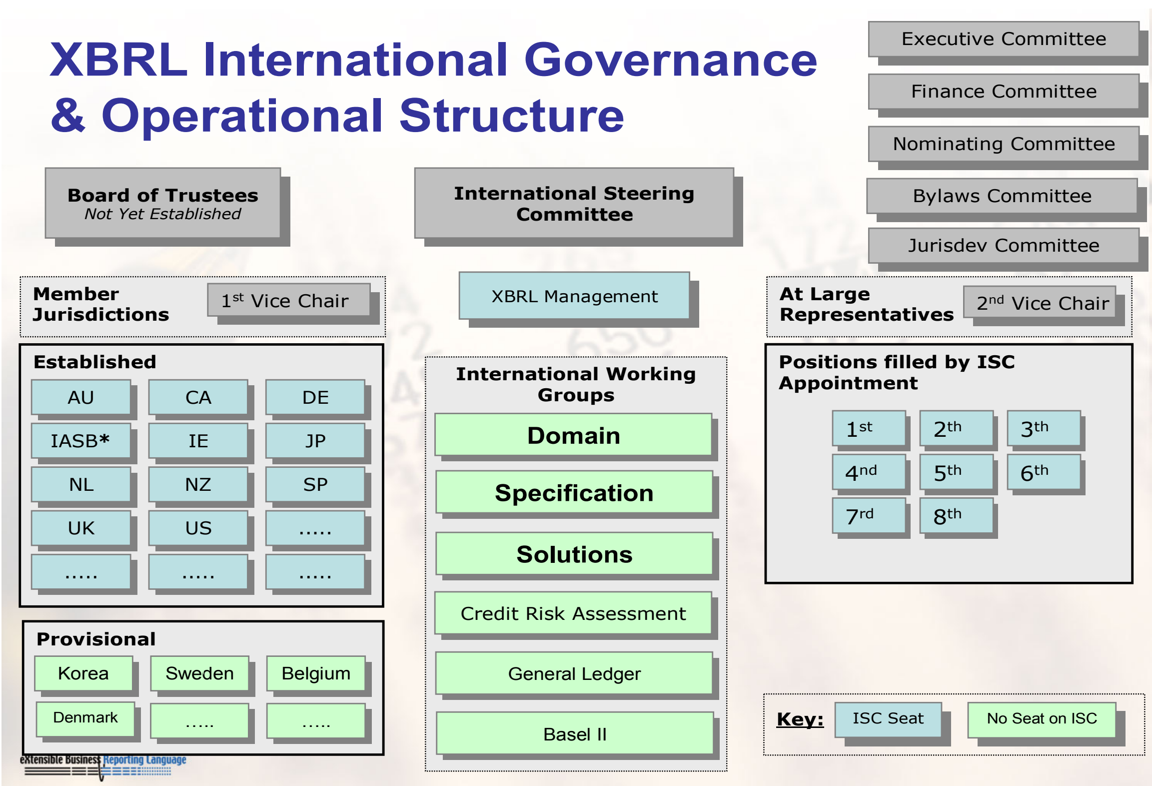
What is the eXtensible Business Reporting Language … XBRL?

- XBRL is a language for the electronic communication of business and financial data. It provides major benefits in the preparation, analysis and communication of business information. It offers cost savings, greater efficiency and improved accuracy and reliability to all those involved in supplying or using financial data. It is an open standard, free of license fees, being developed by a non-profit international consortium.
- An easy way to describe and think of XBRL is as bar coding for business information with similar benefits in cost savings with improved information quality all along the business reporting supply chain. *It does for business information what bar coding did for product distribution.*
- More technically, XBRL is a dialect of XML technology specifically designed for the business reporting supply chain. XML (eXtensible Markup Language) is a standards-based Internet language for defining and naming data that was approved by the World Wide Web consortium (W3C) in February 1998. XML is revolutionizing the Internet by allowing users to exchange information across any application, browser or technology platform in a simple, straightforward manner. This is accomplished with self-describing XML "tags" for that information.
- Like XML, XBRL is freely available, works with any technology (primarily over the Internet and private networks) and uses "tags" to describe business information. The first application of XBRL tags – otherwise known as "taxonomy" – to be developed is XBRL for Financial Statements, and was quickly followed by the XBRL General Ledger.

XBRL

The XBRL organization

- XBRL International is a not-for-profit consortium of over 250 corporate members strong in 15 member jurisdictions with leading CPA firms, software companies, data aggregators, and major regulators as members from around the world working together to build the XBRL language and promote its adoption. This collaborative effort began in 1998 through the efforts of the AICPA and its members and has produced a variety of specifications and taxonomies to support the goal of providing a standard, XML-based language for digitizing business reports in accordance with the rules of accounting in each country or with other reporting regimes such as banking regulation or performance benchmarking.
- The AICPA and the CPA profession continue to play a strong and leading role in this effort.



XBRL

Benefit to Members

- XBRL is not just for reporting to the SEC.
- By using XBRL, companies and other producers of financial data and business reports can automate the processes of data collection. For example, data from different company divisions with different accounting systems can be assembled quickly, cheaply and efficiently if the sources of information have been upgraded to using XBRL.
- When XBRL is ubiquitous, you will use it for both internal and external reporting in a greatly streamlined fashioned. Today there are multiple external reports that are redundant. The current FDIC Call Report modernization project is really the FFIEC project and is consolidating reporting across all banks for 5 supervisory authorities. *Create once and render many.*
- For AICPA members who serve in financial management, auditing, and information technology roles, XBRL will streamline the preparation of business and financial reports for internal and external decision making. *XBRL will significantly improve the ability for CPAs in financial management to more precisely direct and publish financial information to investors, regulators, analysts, lenders and other key stakeholders*. Moreover, the CPA profession is proactively fulfilling its primary mission to protect the public interest as XBRL will improve investor access to the capital markets and increase analyst coverage.

What are the potential uses of XBRL?

- XBRL can be applied to a very wide range of business and financial data. Among other things, it can handle:
  - Company internal and external financial reporting
  - Business reporting to all types of regulators, including tax and financial authorities, central banks and governments
  - Filing of loan reports and applications; credit risk assessments
  - Exchange of information between government departments or between other institutions, such as central banks
  - Authorative accounting literature - providing a standard way of describing accounting documents provided by authoritative bodies
  - A wide range of other financial and statistical data, which needs to be stored, exchanged and analyzed

How do companies create statements in XBRL?

XBRL

- There are a number of ways to create financial statements in XBRL:
  - XBRL-aware accounting software products are becoming available, which will support the export of data in XBRL form. These tools allow users to map charts of accounts and other structures to XBRL tags.
  - Statements can be mapped into XBRL using XBRL software tools designed for this purpose.
  - Data from accounting databases can be extracted in XBRL format. It is not strictly necessary for an accounting software vendor to use XBRL; third party products can achieve the transformation of the data to XBRL.
  - Applications can transform data in particular formats into XBRL. For example, web sites are in operation, which transform EDGAR filings in the United States into XBRL, providing more efficient access to specific data in the filings.
  - The route, which an individual company may take, will depend on its requirements and the accounting software and systems it currently uses, among other factors.

Why are Accounting Institutes around the world taking a major role in the XBRL consortium?

- A core purpose of Accounting Institutes around the world is to enhance the access, quality and breadth of financial information available to the investing public. XBRL will help achieve this. Institutes also believe that the development of XBRL will help position their members as valued knowledge providers for their clients. Businesses, large and small, are undergoing fundamental change. Accountants, as the managers of the underlying language of business, can help organizations fit into the new digital world, solve business issues and capitalize on opportunities.