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AICPA Board/Council Briefing Synopsis, Updated as January 1, 2006

American Institute of Certified Public Accountants (AICPA)

AICPA

Board/Council

Briefing Synopsis

Updated as of

January 1, 2006

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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 Boards 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 and internal controls and an auditors report on that assessment

SARBANES-OXLEY IMPLEMENTATION

- 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.

ANTIFRAUD AND CORPORATE RESPONSIBILITY PROGRAM

- 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.
- 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.

OUTREACH PROGRAMS

- 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 public 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.

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 the 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. The AICPA's UAA Committee members also will devote time to the Rules process.

THE AICPA/NASBA UNIFORM ACCOUNTANCY ACT (UAA)

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.
- See discussion in **Recent Activities** section concerning proposed revisions to the UAA relating to Substantial Equivalency for firms.

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.

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.

THE AICPA/NASBA UNIFORM ACCOUNTANCY ACT (UAA)

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.
- See discussion in **Recent Activities** section concerning proposed revisions to the UAA relating to the transparency of the Peer Review process.

Attest Services

- The UAA defines attest services to include audits, reviews and examinations of prospective financial information performed in accordance with applicable professional standards (See discussion in **Recent Activities** section concerning the proposed minor revision to the definition of attest in the UAA Exposure Draft).
- Performance 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.
- 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

UAA Exposure Draft

- In August of 2005, the Joint Uniform Accountancy Act (UAA) Committee of the AICPA and the National Association of State Boards of Accountancy (NASBA) issued a 60-day exposure draft on revisions to the UAA Statute.

Significant Revisions included in the UAA Exposure Draft Includes:

- Amending the section relating to Peer Review giving the board the authority to obtain peer review materials from the administering entity, and require the licensee to remit peer review documents to the board as specified by rule.
    - In order to keep its commitment to its membership, the following statement would appear with an asterisk after each applicable section, "Due to its 1988 commitment to its members, the AICPA cannot support this provision at this time."

- Adding two new provisions under Substantial Equivalency to add the concept of firm Substantial Equivalency. Section 7(i) would address the following:
    - Allows substantially equivalent CPA employees from out of state to exercise practice privileges in a state on behalf of a CPA firm that has a permit in a state without notifying the board.
    - Requires the firm to keep track of employees and to submit their names to the board upon request.
- Section 7(j) would address the following:
    - Allows a CPA firm that **does not** have a permit in a state to file a master notice with NASBA's National Qualifications Appraisal Board.
    - Allows the CPA practice privileges in that state providing they are substantially equivalent under the UAA (i.e. satisfied the 3E's) and the CPA would not be required to notify the board upon entering the state.
    - Amending Appendix C by extending the exemption for the 150 hour requirement from 2001 to 2012 for licensees who passed the exam prior to January 1, 2012 that wish to enter a state as an individual under substantial equivalency.
    - Adding a section that requires that information obtained by the board in the course of an investigation is confidential and exempt from public open record laws.

<u>Other Revisions Include</u>:

- Amending the definition of attest to include any financial statement service engagement to be performed in accordance with Statements on Standards for Attestation Engagements (SSAE) and to recognize the Public Company Accounting Oversight Board (PCAOB) as a standard setting body.
- Adding the definition of Principal Place of Business.
- Allowing the Board of Accountancy to cooperate in investigations with appropriate state and federal regulatory authorities as well as appropriate foreign regulatory authorities providing those foreign authorities regulate the practice of public accountancy.

THE AICPA/NASBA UNIFORM ACCOUNTANCY ACT (UAA)

Next Steps

- Review Comments in October. Present final revisions to NASBA and AICPA Boards, respectively in October and December.
- If approved, a new edition of the UAA Statute is expected to be released in early 2006.

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 became effective 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, the Public Company Accounting Oversight Board (PCAOB), and IRS Office of Professional Responsibility.
    - Members and the PEEC would each have the right to appeal the automatic sanction.
    - In October 2003, members 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 has been 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

The Need for 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, as did subsequent efforts including the Elliott Committee and the Accounting Standards Task Force of the Group of 100.

ENHANCED BUSINESS REPORTING

The Special Committee on Enhanced Business Reporting

- In January of 2003, the AICPA established the Special Committee on Enhanced Business Reporting to pick up where these other initiatives had left off. The objective of the Special Committee's work was to develop the migration path to improve the quality and transparency of business reporting as part of the process to rebuild investor confidence and protect capital markets.
- In January of 2005, the AICPA Special Committee on Enhanced Business Reporting completed its two-year term upon achieving its 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 Enhanced Business Reporting Consortium

- The Enhanced Business Reporting Consortium (EBRC) is incorporated in the state of Delaware as a 501(c)(6) not-for-profit organization.
- Existing Charter Members include the AICPA Center for Public Company Audit Firms, Deloitte, Ernst & Young, Grant Thornton, KPMG, Microsoft Corporation, and PricewaterhouseCoopers.
- Existing Consortium members are currently working to recruit additional corporate and investment community members, along with the help of a diverse group of international strategic partner organizations that have come together to make this endeavor a reality. Our strategic partners include the AICPA, the Business Roundtable, Business Wire, the Confederation of British Industry, the International Chamber of Commerce, the National Association of Corporate Directors, NASDAQ, the National Investor Relations Institute, the Open Compliance and Ethics Group, PR Newswire and XBRL International.
- We are also fortunate to have the counsel of: Norm Augustine, member of the Boards of Directors of Proctor & Gamble, Black and Decker, ConocoPhillips, and Lockheed Martin; Maria Livanos Cattaui, Secretary General of the International Chamber of Commerce; Roderick Hills, former Chairman of the Securities and Exchange Commission; Ned Regan, retired President of Baruch College; Don Tapscott, CEO of New Paradigm Learning Corporation and author of The Naked Corporation; Paul Volcker, Chairman, International Accounting Standards Committee Foundation and former Chairman of the Federal Reserve Board; David Walker, Comptroller General of the United States; and Peter Wallison, Resident Fellow of the American Enterprise Institute.

ENHANCED BUSINESS REPORTING

A Framework for Enhanced Business Reporting

- The Enhanced Business Reporting Consortium will work toward consensus on an internationally recognized framework of voluntary, international guidelines for Enhanced Business Reporting that supports delivery of information with improved relevance and comparability for decision making. This framework will have the following components developed on an industry basis:
  - Generally accepted definitions, measurements, and voluntary disclosure guidelines for industry-specific, process-oriented value drivers and key performance indicators
  - Generally accepted, voluntary disclosure guidelines for information about opportunities, risks, strategies and plans, and about the quality, sustainability and variability of cash flows and earnings
- The Enhanced Business Reporting Consortium will also work toward a stronger focus on the quality, not quantity, of reported information by:
  - Identifying information that is either of marginal use to the investor and creditor communities or redundant
  - Developing thoughtful proposals to eliminate needless complexity and costly duplication
  - Using technology and best practices to streamline the business reporting process
- The Private Companies Enhanced Business Reporting Task Force, an ongoing task force of the AICPA, will provide private company creditors, private companies, and regional and local CPA firms with a voice in the development of the enhanced business reporting framework, to ensure that it is scaleable for non-regulated, privately-held businesses.

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 through enhanced transparency.
- 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

PRIVATE COMPANY FINANCIAL REPORTING

Overview

- In late 2003, the AICPA Board established a special task force whose primary charge was:

    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.

- In March of 2005, the task force issued its report.

Report Conclusions

- GAAP for private companies should be developed based on concepts and accounting that are appropriate for the distinctly different needs of constituents of that financial reporting.
- Although GAAP exceptions and other bases of accounting are being used and are sometimes appropriate, the Task Force does not believe that these exceptions and other bases of accounting are the best response to the private company financial reporting findings identified in this study.
- Fundamental changes should be made in the current GAAP standards-setting process to ensure that the financial reporting needs of private company constituents are met.

Background on The Task Force and the Process

- These conclusions are based on research conducted among over 3,700 lenders, investors, sureties, business owners, financial managers and public accounting practitioners. This research effort was the most comprehensive ever undertaken on the issue of private company financial reporting.
- The task force that sponsored the research was brought together by the AICPA, but it is important to note that it was comprised of representatives of key constituents of private company financial reporting.
- It includes representatives of private company business owners and financial managers, practitioners, lenders, investors and a former standards setter.
- After studying the results of the research to identify significant findings, the task force was asked to draw from their backgrounds and experience to reach conclusions and make recommendations based upon those findings.

PRIVATE COMPANY FINANCIAL REPORTING

- As part of its process, the task force created a discussion paper designed to help ensure an informed, unbiased dialogue on the topic.
- The research was conducted by an independent market research firm, The MSR Group of Nebraska.
- More information about the Task Force, its process, its report and the research effort can be found at http://www.aicpa.org/members/div/acctstd/pvtco_fincl_reprt/index.htm.

Key Research Findings

- The key constituent groups gave a fairly high rating to the overall value of GAAP on things like consistency and its use as a tool in capital allocation decisions. However, all key constituent groups rated too many GAAP requirements as needing to be more relevant and useful.
- In addition, the Task Force found that a majority of each of the constituencies that had an opinion believe it would be useful if the underlying accounting in GAAP reporting were different, in certain instances, for public versus non-public (private) companies.

Marketplace Implications

- We are calling for standards that focus specifically on the information needs of the key constituents of private company financial reporting.
- Our expectation is that the resulting standards will result in high quality financial information that is no less in quality than that provided about public companies.
- Each company and its stakeholders would need to decide what makes sense for them. For example, a private company looking to go public in a few years very well may choose to stick with public company, GAAP.
- The research effort among key stakeholders of private company financial reporting was only the beginning of our effort to engage in a broad-based dialogue on this issue. We will continue to work with key constituent organizations representing these stakeholders in an effort to reach out to the grass roots – the small business owners and managers, loan officers, venture capitalists, sureties and others.
- We need their feedback and the feedback of everyone in the CPA profession, particularly those local practitioners and members in the industry that work with private companies, in order to ensure that this very important effort stays on target.

PRIVATE COMPANY FINANCIAL REPORTING

Where are we now?

- The AICPA Board of Directors and governing Council are on record as supporting "the development of high quality GAAP for privately-held, for-profit entities based on concepts and accounting that are appropriate for the distinctly different needs of constituents of private company financial reporting."
- We directed the AICPA management team to work with the Financial Accounting Foundation and the Financial Accounting Standards Board to identify and implement a process to develop GAAP for privately-held, for-profit entities. This would result in recognition, measurement and disclosure differences, where appropriate, from current GAAP as applied by public companies.
- An AICPA/FASB working group comprised of members and staff considered a number of different process models and proposed a process model that it believes is a constructive path forward.
- The working group is continuing to work on details of the proposal and is beginning to discuss it with the respective boards of the AICPA and the FAF.
- The AICPA and FASB share a commitment to exposing any proposed model with a broad range of constituents of private company financial reporting.
- The timing of that broader exposure will be after we have presented a proposal to AICPA Regional Council in March of 2006.

THE COMPUTER-BASED UNIFORM CPA EXAMINATION

- While first-year Exam volume was disappointing, second-year volume is trending up and candidate satisfaction remains high.
  - Volume may exceed 180,000 scheduled test sections for period April 2004 through May 2006; no-show rate is about 7%.
- Volume Task Force determined candidate workload was a significant factor in low volume numbers; change in test format also made it more difficult for employers to track employee Exam progress.
- Work is underway to help firms and employers encourage and track staff exam status.
  - PCPS recently distributed a model CPA-exam policy statement and a tracking spreadsheet/template to help firms encourage and monitor staff progress toward the CPA exam; handouts and flyers also planned.
- The low volume also creates financial pressure on the Exam.
  - Although candidates do not see the cost of the Exam as a barrier, state boards are very critical of fee increases.
  - Revenue as of 7/31/05 was $5M less than anticipated, and the AICPA incurred a $2.7M true-up expense to Prometric for hourly seat charges.
  - The AICPA is obligated to break-even over the course of the CBT contract.
  - The AICPA exam fee is currently $45/section and will increase to $65/section in 2007.
- Cumulative CBT pass rates are in low to mid 40% range (about 10% higher than the paper-based exam), which represents the change in how people study for and take the exam.
- State board response to CBT has been mixed.
  - Many activities they used to do themselves are now being done on their behalf by other parties; this has created a sense of loss of control.
  - California and New York have called for an RFI to identify potential alternate providers for the Exam; NASBA has established a task force to study the issue.
  - Exams Team has launched an initiative to improve relationship with state boards of accountancy.

THE COMPUTER-BASED UNIFORM CPA EXAMINATION

- The AICPA continues to work on improving the testing experience for all candidates.
    - Accelerated score reporting began in August 2005; the AICPA now releases scores to NASBA earlier for some candidates who test in the first month of a testing window; remaining candidate scores are released in the following month. (NASBA and the state boards of accountancy still determine when scores are actually sent to candidates).
    - Upgrade to examination simulation software (Sims 1.5) originally planned for January '06, was postponed due to Authoritative Literature linking issue. This upgrade will improve simulation functionality and address candidate complaints with copy/paste.
- There is increased interest in administering the Exam internationally.

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 few years, the national media has covered every corporate failure and accounting irregularity with 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 Program 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: Working in the Public Interest (business, investor, and government audiences), Financial Literacy (for the public), Recruitment (of the next generation of the profession) and Working with Small Business (CPA Relationship).

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CPA AMBASSADOR PROGRAM

- 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 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 5, 2005, 572 members in 45 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 few 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
- Our focus in the first four years of the campaign was to publicize and encourage as many students as possible to visit frequently the campaign's Web site, www.StartHereGoPlaces.com, for the information, understanding and experience of the CPA profession so that they may take desired action.
- The campaign continues to communicate with high school juniors and seniors as well as college students about the world of business and accounting. Through that lens, the myriad of opportunities and experiences available by majoring in accounting and pursuing CPA certification is highlighted.
- Each year our campaign objectives mature to better address the needs of students and "migrate" them closer to pursuing accounting and later CPA certification.
- The fourth year of the five-year direct marketing effort aimed at 16-22-year-olds ("Generation Y") was launched in October 2004 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

CPA STUDENT RECRUITMENT CAMPAIGN

- We used successful channels to build awareness, drive traffic to StartHereGoPlaces.com and reach more students committed to pursuing accounting.
  - Direct Mail
  - E-mail and E-Newsletters
  - Posters, newspapers, bookmarks
  - Web site sponsorships, search engine marketing, advertising

Results as of July 2005:

- More than 960,000 unique responders
- More than 273,000 registrants
- More than 168,000 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.

CPA2BIZ

Opening Statement

- CPA2Biz is a separate privately-held company, of which the AICPA is the majority 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 and 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 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

- AICPA's relationship with C2B is this - 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, please 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.

CPA2BIZ

- 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 and a half 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. Over the past three years, it has produced improving financial results, moving the company to profitability in FY2005. 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. 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 CPA2Biz site (www.cpa2biz.com) has become the leading e-commerce site for the CPA profession. More than 200,000 CPAs regularly use the CPA2Biz site to access articles, online literature, continuing professional education, career resources and a selection of more than 1,000 professional products and services.

- Sophisticated shopping tools allow CPAs to see real-time stats on the products their peers are buying, as well as locate relevant products quickly through tools like the CPE self-study product finder and a powerful search engine. Users can now preview hundreds of products before making a purchase by taking advantage of special features like sample sections and video clips, helping CPAs make more informed buying decisions.

- With the addition of such state-of-the-art capabilities, almost 50% of all new AICPA product orders are now placed through the CPA2Biz site, a significantly higher online order percentage as compared to other leading professional associations. This demonstrates the special focus and expertise CPA2Biz is providing to the AICPA and its membership.

CPA2BIZ

- An April 2005 customer survey revealed that 92% of CPA2Biz online customers polled would recommend www.CPA2Biz.com to a colleague, up from 86% in January 2005.

- Nearly 40,000 site searches are conducted on average each month, on topics such as COSO, ethics, SAS 99 and CPE.
- CPA2Biz is also helping CPAs build stronger relationships with their clients through the AICPA Business Solutions Program, which was launched by CPA2Biz in the fall of 2003. Over 15,000 CPA firms nationwide are now enrolled in the program, four states in particular (CA, FL, NY and TX), representing over 1,000 firms each.

- The AICPA Business Solutions program includes offerings in three core areas: payroll, small business banking and 401k. Each offering allows firms to provide unique value to clients, all the while ensuring CPAs maintain an ongoing role in the decisions impacting the CPA-Client relationship.

- To date, CPA firms have referred thousands of clients through this program with over 90% stating satisfaction with the program offering, and 96% stating their intention to refer additional clients.

- CPA2Biz also provides high quality marketing and technology services to the AICPA. This includes producing hundreds of targeted direct mail and email communications for the AICPA publications, CPE and Conference product lines, all of which experienced positive growth.

- In addition, CPA2Biz's technology team supported the design and the building of the web sites for the AICPA Centers launched over the past year.

Financial Highlights

- CPA2Biz posted its third consecutive year of strong growth moving the company to profitability for this fiscal year. Results were driven by increasing usage of services, strong revenue growth in new business lines and a reduction in historical depreciation expenses.

CPA2BIZ

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 has demonstrated the growth, value and success of the Business Solutions Program, which now has over 15,000 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.

- In Fiscal 2004, the AICPA launched its new Member Solutions Partnership (MSP) platform in collaboration with the state CPA societies. MSP was designed to upgrade the AICPA and state society database system infrastructure to better serve the global membership base.
- The AICPA Board of Directors approved a budget of $10.2 million for the implementation of the Oracle/MSP platform (both CRM and ERP functions). This amount was comprised primarily of software license fees, consulting fees, hosting and training costs and was exclusive of internal salary costs.
- The project went live with a $50,000 budget overrun, which was considered immaterial given the scope of the overall initiative. In addition, approximately $1 million was capitalized in salary costs. All costs associated with the Oracle platform since it went live in November 2003 have been part of the AICPA's normal operating budget.
- Since going live, a number of problems with the MSP platform manifested. The system exhibited both performance and code maturity challenges. Although such operational challenges are to be expected in software implementation of such complexity, these issues coupled with additional challenges related to the data conversion process from our multiple legacy systems, impacted the overall AICPA member experience. The impact was primarily related to delays in the Fiscal 2005 dues bill mailing and in member order fulfillment.
- In parallel to and since the AICPA's implementation, several state CPA societies also went live with either, or both, their CRM and ERP functions on the MSP platform. These state societies included Ohio, Indiana, Louisiana, Delaware, Kansas and Maryland. The state society implementations also exhibited operational challenges most critically related to Oracle's e-commerce functionality.
- During the many months MSP has been live in its beta states, SSLLC worked tirelessly to fine tune the system and attempt to resolve the operational problems. Unfortunately, updated estimates of both the time and dollars required to optimize the remaining functions that are critical for state society operation necessitated their withdrawal from the platform until the major operational issues have been fully resolved.
- Most of the smaller states have already transitioned off Oracle. Ohio is slated for an early October 2005 transition. Remaining assistance from the SSLLC team is expected to be minimal. Plans are underway to integrate the SSLLC development team back into the AICPA Information Technology business unit.

- The AICPA will continue to utilize Oracle CRM/ERP, and has made significant progress on the functionality issues that it experienced. Many of the issues that cause the Oracle platform to not work well in smaller organizations are less critical in an organization the size of the AICPA.
- From the AICPA's perspective, resulting improvements to date include:
    - Fiscal 2006 dues bill mailing occurred on time
    - Cash received prior to July 31, 2005 returned to pre-implementation levels
    - Order fulfillment delays have significantly improved
- Additional enhancements related to improving order entry efficiency, reducing data redundancy and creating a member self-service function are already underway. The AICPA is committed to refining the Oracle platform to meet the needs of the AICPA and its members. The AICPA staff also looks forward to partnering with the state societies on this project in the future.

AICPA SPECIALTY CREDENTIALS

Background:

- 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.

AICPA SPECIALTY CREDENTIALS

Current status:

- The National Accreditation Commission (NAC) reported to the Board of Directors in July 2005 the projected 7/31/05 status of the credentials and the progress of the specialty practice areas. They will also be updating the AICPA Council at their Fall Council meeting.
- Since receiving Council's approval and direction, the AICPA has enhanced the value proposition for the Specialty Practice Areas by developing web communities and providing technical and practice management resources, products and news, membership information and regulatory and legislative updates.
- The NAC also presented various strategic campaigns that each specialty area will execute to continue to increase membership. These campaigns include grassroots outreach by champions and existing credential holders, direct mail campaigns, strategic relationships with appropriate third parties, sponsorship campaigns and telemarketing recapture efforts.

The Credential Numbers:

- As of August 31, 2005, there are: 3326 PFS. Exceeded 2005 metric for PFS at 7/31/05. Increase of 63 in the last month due to numerous campaigns executed.
- As of August 31, 2005, there are: 1774 ABV. Exceeded 2005 metric for ABV at 7/31/05. Increase of 22 in the last month due to June administration of the ABV exam.
- As of August 31, 2005, there are: 694 CITP. Slightly below 2005 metric for CITP at 7/31/05. Increase of 22 in the last month due to efforts executed at TECH conference and direct mail campaigns.

The Membership Sections:

- Significant increases (from at least 75 to as many as 190 new membership section members) in each of the specialty practice areas in the last two months due to direct mail campaigns, dues billings, increases in credential holders and increased awareness and value proposition for each section.

AUDIT QUALITY CENTERS

- 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 and complying with the membership requirements. Each center issues news alerts and has a dedicated Web site, delivering valuable information and resources to members.
- These centers help members improve the quality of their audits of public companies, governmental entities and employee benefit plans. They also send 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.
- 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 (EBPAQC)

- During the past few years, the AICPA has taken significant steps to strengthen the quality of employee benefit plan audits. Each year more than 10,000 CPA firms audit the financial statements of about 75,000 employee benefit plans subject to ERISA. About 5,000 of those firms are AICPA members.
- In the short time since its launch in March 2004, over 1,000 firms have enrolled in the EBPAQC from all 50 states, the District of Columbia and US territories, accounting for over two-thirds of the ERISA audits performed. All CPA firms in the United States, which audit employee benefit plans, are being urged to join.
- The Center provides its members with regular updates on current issues and developments, an online discussion forum to share best practices, 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 facilitate 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 was launched last fall, gives auditors of governmental audits, including Yellow Book audits done under GAO government auditing standards, their own resource center.
- Since launch, over 360 members have joined again, showing the profession's commitment to audit quality.
- 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
- Over 900 members currently

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 audits of 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 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 Ethics Rulings

- At its October 28-29, 2004 meeting, the AICPA Professional Ethics Executive Committee adopted two new and one revised ethics rulings that address a member's responsibilities when outsourcing services to third-party service providers.
- The Committee defines third-party service providers as any entity that the member individually or collectively with his or her firm, does not control (as defined by U.S. GAAP) and any individual who is not employed by the member. Accordingly, the new standards would apply to all independent contractors used by the firm.
- The new ethics ruling under Rule 102, *Integrity and Objectivity*, requires that, prior to sharing confidential client information with the service provider, a member inform the client, preferably in writing, that he or she may be using a third-party service provider when providing professional services to the client. The ethics ruling also emphasizes that members are not required to inform clients of third-party service providers used only to provide administrative support services such as record storage, software application hosting and authorized e-file tax transmittal services.

OUTSOURCING OF CPA SERVICES

- The new ethics ruling under Rule 201, *General Standards*, and Rule 202, *Compliance With Standards*, clarifies the application of rules 201 and 202 to members who use a third-party service provider in providing professional services to clients, and makes clear the committee's position that the member is responsible for all work performed by the service provider. The ruling does not however, extend the member's responsibility for planning and supervising the work of a third-party services provider beyond the requirements of applicable professional standards which may vary depending on the nature of the engagement.
- Finally, the revision to Ethics Ruling No. 1 under Rule 301, *Confidential Client Information* updates and broadens the application of the ethics ruling beyond that of an outside tax service bureau and makes it applicable to any third-party service provider used by the member, including those who provide only administrative support services. While the revised ethics ruling does not require that a member obtain specific client consent prior to disclosing confidential client information to a third-party service provider, it does require a member to enter into a contractual agreement with the third-party service provider to maintain the confidentiality of the client's information. The ethics ruling also requires that members be reasonably assured that the third-party service provider has appropriate procedures in place to prevent the unauthorized release of confidential client information.
- The new ethics rulings are effective for all professional services performed on or after July 1, 2005, except for professional services performed pursuant to agreements in existence on June 30, 2005 that are completed by December 31, 2005.
- The ethics rulings are available on the AICPA Web Site at http://www.aicpa.org/members/div/ethics/2004_1028_outsourcing.htm

PEER REVIEW TRANSPARENCY

- The AICPA's Peer Review Board, Board of Directors and Council have all expressed strong support for increased transparency of peer review results.
- Transparency essentially boils down to making the results of peer reviews more available to interested parties.
- While peer review was originally designed as an educational and remedial program with members expecting, and the Institute delivering, confidentiality throughout the process, the regulatory and business climate has changed.
- Users of peer review have expanded to include regulators and clients, who expect and demand more transparency in all business transactions.
- Since mandatory peer review went into effect in January 1988, tens of thousands of firms have made peer review results available more broadly, through one of three types of situations:
  - By agreeing to join PCPS, SECPS (now CPCAF) or the Governmental or Employee Benefit Plan Audit Quality Centers with a peer review public file requirement.
  - Through a mandate from a state board of accountancy or other regulatory body such as the GAO.
  - Or, voluntarily publicizing, promoting and distributing peer review results as part of the firm's marketing and client relations efforts.
- Regarding those state board mandates, 39 states currently mandate peer review as a condition for licensure. More than half of those also require the remittance of peer review information to the board.
- Some newly proposed revisions to the Uniform Accountancy act will would give state boards the authority to require that
  - administering entities of peer review programs (state societies) provide the board information…
  - licensees remit peer review documents to the board, … and that these documents would be maintained subject to the confidentiality provision.
- So there is clear evidence that the day of confidentiality of peer review results is quickly fading.
- And the leadership doesn't just support greater transparency because it is inevitable; they support it because it is right.
- By taking the lead and making a change to this aspect of self-regulation, the profession would make a strong statement about its ability to regulate itself.

PEER REVIEW TRANSPARENCY

- And perhaps more importantly, we can help to preserve the uniformity of the peer review process across the states.
- The question is, “Where are our members on this issue?”
- Because of our covenant of confidentiality with the members that rose out of the 1988 vote making peer review mandatory, the AICPA is obligated to maintain confidentiality of peer review information until such time as our members vote, by a two-thirds majority, to release it from that confidentiality requirement.
- AICPA’s Board of Directors and Governing Council, having agreed that greater transparency of the peer review process is appropriate, asked AICPA staff to educate members on peer review and the need for greater transparency of peer review results.
- Through this education process and member feedback there are clearly varying opinions across the states and among our members on the specific decisions and actions involved in moving toward greater transparency.
- At the end of this period of education and feedback, we did not believe that we had enough support for mechanisms of greater transparency to ensure the success of a member vote by a two-thirds majority.
- In addition, as part of this dialog, many members expressed their opinions on certain aspects of our peer review programs. This feedback pointed out a definite need to educate members on what peer review is, how it works, and what enhancements have been made recently.
- We established a board-level task force to review the feedback, the current market and regulatory environment, and the recent enhancements to the programs and determine if further changes should be recommended.
- And we have launched a further communication effort to improve our members’ knowledge of the regulatory and market environment as well as an understanding of the peer review programs as they exist today after the implementation of a number of enhancements.
- Transparency continues to be an important and ongoing topic of discussion between AICPA and NASBA and between state CPA societies and individual state boards.
- We plan to continue a healthy and rigorous dialog with NASBA, with state boards, with state societies and with our members about this subject for the foreseeable future.
- Members often want to know why we are doing this – pushing for peer review transparency – now?

PEER REVIEW TRANSPARENCY

- When I answer, I certainly reiterate the facts I mentioned earlier about the changing marketplace and regulatory environments and how peer review results for tens of thousands of firms are already being made available beyond the firm and the peer reviewer.
- But more importantly, I like to tie back this effort to the core values of our profession -- our strongly held beliefs in integrity, objectivity and competence.
- The question we are now considering is - Can we be transparent when it comes to our own internal processes for ensuring quality.
- As a great profession, we have on many occasions demonstrated a willingness to raise the bar on ourselves. The question for the profession is, can we remain and grow as a great profession - and one that controls its own destiny - without greater peer review transparency?

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. Since that date, the Professional Ethics Executive Committee ("the Committee") has undertaken initiatives including the issuance of a number of informal guidance documents to assist members in implementing the Interpretation's provisions. In addition, in January 2005, editorial revisions to the rule were made which further address membership concerns with respect to the "client competency" and "documentation" requirements.
- Some have accused the AICPA of "cascading" Sarbanes-Oxley independence rules to private company audits. That is not the case. The 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 an individual who possesses *suitable skill, knowledge and/or experience to oversee the service.*
- One of the changes made by PEEC in January 2005 was to use this "suitable skills" language to replace the word competence throughout the Interpretation.
- By ensuring that the client has designated an individual who possesses *suitable skill, knowledge and/or experience* 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 that the individual designated by the client to oversee the nonattest services possesses suitable skill, knowledge and/or experience to enable him or her to understand the nature, objective ad scope of the nonattest service, and a requirement that the member's understanding with the client be documented.

INTERPRETATION 101-3 - PERFORMANCE OF NONATTEST SERVICES

- 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 possess a requisite degree of skill, knowledge and/or experience 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.

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"

- The revised Interpretation that became effective December 31, 2003 required that the client designate a *competent* employee to oversee the nonattest services.
- Some members, particularly those affiliated with smaller firms, expressed concerns regarding the practical application of the competency requirement.
- 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 was not the case. In meeting the "competency" requirement, it was never intended that the client employee possess a level of technical expertise commensurate with that of the member.

INTERPRETATION 101-3 - PERFORMANCE OF NONATTEST SERVICES

- In order to clarify the PEEC's intent, at its January 2005 meeting the Committee agreed to replace the term "competence" with the words "suitable skill, knowledge and/or experience" throughout the interpretation.
- In addition, the Committee agreed to replace the term (client) "*employee*" with "*individual*" to clarify that the person designated by the client to oversee the service could be the owner of the company or an individual outside the company such as an outsourced bookkeeper or controller.
- Thus, the individual designated by the client should possess the skill, knowledge and/or experience to enable him or her to understand the key issues involved, make any required management decisions and evaluate the adequacy of the resulting work product.

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; and
  - Any limitations of the engagement.
- In order to provide members with additional time to update firm policies and procedures and further educate their staff, this documentation requirement was deferred until December 31, 2004.
- In January 2005, the Interpretation was revised to reflect that a failure to document the understanding with the client would *not* be considered to impair a member's independence provided such understanding had been established; but rather, would be considered a failure to comply with an ethics standard under Rule 202 – *Compliance With Standards*.
- The Committee also agreed that it was no longer necessary to provide for an exception where the failure to document the understanding was *isolated and inadvertent* so this "exception" was deleted.

INTERPRETATION 101-3 - PERFORMANCE OF NONATTEST SERVICES

Further guidance and clarification

- There are available resources to assist our member's in understanding the provisions of Interpretation 101-3. These resources are available online at: http://www.aicpa.org/members/div/ethics/intr_101-3.htm
- 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

STATE ACCOUNTING REFORMS

The State Cascade

Background on the State Cascade Effect

- Even before the passage of the Sarbanes-Oxley Act (SOX) 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 small CPA firms and smaller 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.

2005 State Legislative Activity

- Nine bills were introduced in six states and those provisions included, limitations on non-audit services; work paper retention and auditor rotation.
- Five bills were introduced in four states concerning corporate governance reforms relating to non-profit organizations. Based on the gross revenue of the non-profit organization, those provisions included, CEO/CFO certification; mandating non-profits establish audit committees, as well as undergo an audit.
- The NY Legislature approved legislation that established audit committees in school districts; requires an RFP process for selecting auditors every five years; and creates an internal audit function within each school district's financial management team.
- This compared with activity in 2004, where fifteen bills were introduced in five states. Those provisions included limitations on non-audit services; work paper retention; auditor rotation and stricter government enforcement penalties. Seven bills were introduced in two states concerning corporate governance reforms.

STATE ACCOUNTING REFORMS

State Executive Branch/Regulatory Activity

- Not all of the activity has occurred in the state legislative arena. There has been significant activity at the state executive branch and regulatory level.
- On February 3, 2005, Governor George Pataki issued Executive Order 135 creating the New York State Commission on Public Authority Reform. The Commission was instructed to develop model principles for establishing guidelines for governing the independence of board members, establishing audit and management committees and establishing codes of conduct.

Other state regulatory agencies who proposed reforms

- In March of 2004, the National Association of Insurance Commissioners (NAIC) issued an exposure draft on their Model Audit Rule (MAR) that would require a five-year audit partner rotation (the current rule is seven years), limitations on non-audit services and a one-year cooling off period. **The Exposure Draft is still under consideration**.
- 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 Attorneys General are also very active in pursuing reforms primarily aimed at 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 ACCOUNTING REFORMS

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 is currently reviewing positions and plans to recommend further guidance.
- 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.”
- States from across the country that have been faced with accounting reform proposals as a result of SOX have successfully used “A Reasoned Approach to Reform” to educate CPAs, members of the business community, state legislators, regulators and the executive branch.
- For a copy of 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, 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.

ASB, PCAOB AND PRIVATE COMPANY AUDITING STANDARDS

- 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. It is alarmed at the continued decline of savings, retirement planning and the financial preparedness of the American public.
- 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 profession responded to this alarming trend by launching in May 2004 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.
- 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 is leading the profession in a national effort to advance the financial literacy of Americans. Toward this end, they are working to increase awareness of the importance of financial literacy education, build liaisons within the financial literacy community, and promote efforts involving CPAs.
- A centerpiece of the 360 effort is the consumer Web site, www.360financialliteracy.org. Here consumers find information to help them make sound financial decisions at every stage of their lives, from childhood to retirement. A new section of the Web site, Ask the Money Dr., helps consumer's access financial advice from CPAs.
- Since launching on October 24, 2004, the consumer site has received over 5.1 million hits and averages nearly 1,200 unique visitors daily. The site received the 2005 Web Award for Outstanding Achievement in Web site Development, Standard of Excellence from the Web Marketing Association.

FINANCIAL LITERACY

- The 360 Degrees of Financial Literacy program has won many awards recognizing its unique approach and extensive outreach. Awards include the prestigious Summit Award from the American Society of Association Executives, recognizing associations that develop innovative community outreach programs. Other awards include the Clarion Award from the Association for Women in Communications and the Crystal Award of Excellence from The Communicator.
- The program also has been recognized at the national level by many regulators and government leaders, including John Snow, Secretary of the U.S. Treasury, David Walker, CPA, Comptroller General and Congressman Ruben Hinojosa from Texas.
- The AICPA and the Ad Council have signed an agreement to launch a national public service advertisement campaign on financial literacy. The effort will focus on helping Americans positively change money management habits and will lead consumers to the AICPA's financial literacy resources and Web site. The ads are currently being developed and will be ready in the late spring of 2006.
- The AICPA's 360 Degrees of Financial Literacy for Women program is an enhancement of the 360 Degrees of Financial Literacy effort. Developed by the AICPA's personal financial planning section, it focuses on educating and empowering women to take control of their personal finances and achieve greater financial well-being. The program includes a dedicated section of the 360 Degrees of Financial Literacy consumer Web site, www.360financialliteracy.org/women, which was recognized as an outstanding new Web site with the WebStar award from WebCPA. The program also includes educational outreach to women and women business owners through a partnership with the Department of Labor Women's Bureau and Employee Benefits Security Administration.
- The national 360 Degrees effort does not provide a “one size fits all” approach to financial literacy. Rather, it offers an umbrella and resources for states societies to leverage the CPA presence across the country. To accrue the greatest benefit to the profession, the state societies are asked to include the tag line “360 Degrees of Financial Literacy,” and the logo on their Web sites and in their press releases and materials developed for their programs

FINANCIAL LITERACY

- The state CPA societies have the opportunity to choose to participate in the effort in a number of ways. States organizing financial literacy activities should first 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.
- Fifty out of 54 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. To view this report, visit http://www.aicpa.org/financialliteracy/download/SS_Status_Report_Current.pdf
- Since May 2004, AICPA and state society efforts, including workshops, seminars, radio shows, newspaper columns and events, have reached 200 million Americans.
- CPAs interested in getting involved should first visit the CPA Financial Literacy Resource Center, www.aicpa.org/financialliteracy. The site includes a wealth of tools to help CPAs volunteer in their local communities. These include the CPA Mobilization Kits, created by the AICPA and the California Society of CPAs, which are ready-made presentation kits on financial literacy topics. Each includes a PowerPoint with notes and fact sheets. The site also features a free CPE course to help CPAs prepare for volunteering in their communities, as well as other guidance and resources to help CPAs participate.
- CPAs wanting additional information on the 360 effort should register on the volunteer database. By registering, CPAs can keep apprised of the latest developments. They receive regular updates, a newsletter with suggestions for volunteering and links to additional resources and invitations to financial literacy conference calls. Go to: http://volunteers.aicpa.org/financialliteracy.
- To recognize CPAs active in volunteering in financial literacy, the AICPA offers a certificate honoring their achievement. To qualify for the certificate, a CPA must be a member of the AICPA and a state CPA society and have 5 volunteer financial literacy occurrences. They must also perform 7 or more hours of volunteer service leading or presenting financial literacy programs or serving as a leader of an AICPA or state society committee/group/task force, whose main focus is on financial literacy.

FINANCIAL LITERACY

- To help Americans regain financial balance following disaster or to establish a plan to prepare for one, the AICPA and the National Endowment for Financial Education (NEFE), with support from the AICPA Foundation, jointly developed two guides: *Disaster Recover: A Guide to Financial Issues* and *Disaster Planning: A Guide to Preparedness.*
- The AICPA is one of six organizations sponsoring the Project for Financial Independence, the nation's first multi-organizational pro bono financial planning effort. The project offers free financial guidance to individuals who cannot afford a financial advisor, or who are facing an immediate or unusual financial need. For more information, visit www.consultaplanner.org.
- Each year, AICPA members volunteer as tax experts to answer questions received on USA Today's Web site. Questions from online tax chats are used to develop a feature story about hot tax topics that runs in the newspaper's money section, read by more than two million Americans every day.
- Realizing that financial literacy is a vast problem, the CPA profession is committed to maintaining long term involvement. 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.

AUDITOR ROTATION IN HEAD START LEGISLATION

The Issue

The House Committee recently voted out the Head Start reauthorization legislation (H.R. 2123), which would require annual audits and audit firm rotation for all audits under the Head Start program.

AICPA Position

We have no issue with the mission and purpose of the federal Head Start program, the federal early childhood program providing grants to local organizations giving preschool education to poor children. However, we oppose the rotation of auditors of the program's grantees because this would negatively impact small CPA firms and the availability of auditors for the program. We also oppose the annual audit requirement because it would cause problems under the Single Audit Act by disrupting the audit rotation provisions in the Act.

Rotation is not appropriate for the following reasons:

Audits Not Cited In Report on Abuses in Head Start

The General Accountability Office (GAO) is an arm of the U.S. Congress used **to analyze and recommend ways to improve the performance and accountability of Federal programs**. The GAO was asked by Chairman Boehner to look into the Head Start program amid recent reports of financial improprieties at a number of Head Start programs around the country which raised questions about the effectiveness of grantee oversight. The GAO study, issued in February 2005, directed its recommendations at the administering government agency (Department of Health and Human Services, or HHS) and not toward the audit function. The GAO report found the audit function is working correctly and focuses its recommendations on improving the Head Start program in analyzing the data it is receiving from auditors and others to improve grantee financial management. When AICPA staff met with the Chairman's committee staffers, they confirmed that there have not been problems with the audits.

Cost

The cost of audits and the willingness of some auditors to perform all or part of the audit on a pro-bono basis make rotation impractical.

AUDITOR ROTATION IN HEAD START LEGISLATION

Specialized Expertise

The availability of auditors with the appropriate expertise can be quite limited, based on where the organization is located and the size and complexity of its operations. A small accounting firm with three to five partners may only have one partner with competence in these audits. It is expensive for a small firm to maintain this expertise for more than one partner (i.e., meeting all continuing education requirements, etc.)

Low Margin Audits

Most of these audits are not large revenue-generating engagements and if too much onus is placed on the auditor, small accounting firms would simply not do them.

Sarbanes Oxley Is Not Appropriate Here

The AICPA fully supports the Sarbanes Oxley Act, which dictates that every five years the lead or coordinating audit partners for public companies must rotate off the audit team. For the reasons outlined above, it is simply not appropriate to extend this to audits of non-public entities.

Status of Bill

The House bill was adopted on September 22, 2005. The Senate bill (S. 1107), also awaiting floor action, has no similar audit provision.

Action Requested

The AICPA has worked with Chairman Boehner's Education and the Workforce Committee staff to have the auditor rotation requirement dropped for the reasons stated above. Although the bill is significantly improved, we will continue to work with the staff to effect changes when the bill goes to Conference with the Senate bill.

AICPA Staff Contacts

Mark Peterson, Vice President, Congressional & Political Affairs,
mpeterson@aicpa.org, 202/434-9206
Lisa Dinackus, Manager, Congressional & Political Affairs,
ldinackus@aicpa.org, 202/434-9276

TAX ISSUES

<u>Promoting Tax Ethics/ SSTS Tax Practice Quality Control</u>

- A strategic initiative introduced last year and designed to promote a better understanding of the AICPA's Statements on Standards on Tax Services (SSTSs) – the Institute's tax ethical standards — continues to be implemented. First, as we had done in 2004, the Tax Division participated in the *IRS Nationwide Tax Forums 2005* breakout session on Circular 230. (See also, Circular 230 item that follows.) In addition, the Division continues to reach out to the state CPA societies to conduct SSTS sessions at their conferences, as well as at AICPA conferences (a number have already been scheduled). Finally, the Spring Tax Division Meeting held in June, the "annual meeting" of the Division's committee structure, focused on ethical issues including Circular 230 and tax practice quality control. The two key speakers at the meeting were IRS Commissioner, Mark Everson and Justice Department Assistant Attorney General (Tax Division), Eileen O'Connor, both of whom are CPAs.

- The Division's Tax Practice Responsibilities Committee continues to develop a new ethical standard (originally considered as an Interpretation, but now Proposed Standard No. 9, *Tax Practice Quality Control*) indicating that a member should have a system of quality control for his or her tax practice. This includes the five elements of quality control (advocacy, integrity, and objectivity; personnel management; acceptance and continuance of clients and engagements; performance of professional services; and monitoring) and other matters essential to the effective design, implementation and maintenance of the system. The task force drafting the proposal led a discussion of the latest draft at the Spring Tax Division Meeting in order to gauge member reaction to the proposal. The task force is now reacting to feedback received from an "internal" distribution of the proposal (from PCPS, TIC, and PEEC).

TAX ISSUES

Circular 230

Due to the broad applicability to many of our members, the Tax Executive Committee formed a task force to coordinate member educational/informational needs with regard to the Circular 230 changes that became effective June 20, 2005. Projects underway include: an "E-Alert" with immediate informational needs; a practice guide including sample client letters; a comprehensive article to appear in *The Tax Adviser*; a checklist; an updated and comprehensive web presence, including discussion forums and links; a PowerPoint presentation; the filming of a 10/31 National Conference presentation by the IRS Deputy Director of the Office of Professional Responsibility; and the development and promotion of a Speakers Bureau.

IRS/Treasury Priority Guidance Plan

- The AICPA submitted over 100 suggestions regarding the 2005-2006 IRS/Treasury Priority Guidance Plan, which were prepared by the Tax Division's committees, technical resource panels and task forces. The Guidance Plan prioritizes the administrative guidance, which the Treasury and IRS expect to release in its Plan year beginning July 1, 2005.

- Additionally, the Institute again encouraged the Treasury and the IRS to continue pursuing tax simplification. In the letter, we recognized recent simplification steps taken, including: (1) consolidating section 401(k) guidance into one set of final regulations; (2) allowing employers to extend the deadline for reimbursement of health and dependent care expenses up to two-and-a-half months after the cafeteria plan year (IRS Notice 2005-42), and (3) issuing Rev. Proc. 2005-14, dealing with the interplay of sections 121 and 1031, which contains helpful guidance that has simplified and clarified compliance relating to the interaction of those two sections.

TAX ISSUES

Letter to Commissioner on Outsourcing

The AICPA sent a commendation letter to IRS Commissioner Everson for his Congressional testimony on May 26, 2005. This letter stated that taxpayers should be informed whenever a tax preparer outsources the preparation of a tax return overseas and offered our assistance to the Service, should the agency decide to draft regulations addressing the confidentiality and disclosure issues associated with tax return outsourcing. The letter, which also refers to the new ethics rulings adopted by the AICPA last year regarding the responsibilities of members when outsourcing services to third-party service providers, was signed by the chairs of the Tax and Professional Ethics Executive Committees.

Tax Reform

- In mid-October, the AICPA will issue its newest tax policy report *Understanding Tax Reform: A Guide to 21st Century Alternatives.* This report, which builds off of the 1995 AICPA study of flat taxes and consumption taxes, anticipates the debate that will result from release of the report of the President's Advisory Panel on Federal Tax Reform, due out at the end of October.
- While the tax reform debate may be different in 2005, many of the reasons that support a call for reform are the same as 10 years ago. Further, the nature of reform proposals remains fairly constant. One area where the debate has changed is greater consideration of hybrid reform approaches – that is, a system with both an income and consumption tax or significant elements of each.
- In his Executive Order creating the bipartisan commission to study tax reform, President Bush mandated that one reform alternative be based on the current income tax. As in the past, the Tax Division's 2005 report, while it does not take a position on any specific proposal, strives to provide policymakers, AICPA members and interested individuals with a clear understanding of the issues and alternatives involved in Federal tax reform. This includes coverage of recent tax reform developments and alternatives. We will also consider appropriate follow-up steps when the President's Advisory Panel releases its report.
- The 1995 tax reform study and the 2005 tax reform report, once it has been issued, can be found at: http://www.aicpa.org/taxreform/.

TAX ISSUES

SFC Staff Discussion Draft on Charitable Governance

- The AICPA submitted comments on the Senate Finance Committee (SFC) staff discussion draft of legislation on charitable governance. The comments were prepared by the Exempt Organizations Taxation Technical Resource Panel and the Not-for-Profit Expert Panel, and approved by our Tax Executive Committee. The AICPA also participated in a roundtable discussion of the draft legislation.
- We have continued follow-up meetings with SFC staff to assist in clarifying and further developing the proposals. With a strong focus on auditing and accounting-related issues, the Not-for-Profit Expert Panel and Exempt Organizations Taxation Technical Resource Panel prepared written comments, which were approved by the Tax Executive Committee and submitted to the SFC on March 1, 2005.
- Follow-up with the House Ways and Means Committee, which is also looking at charitable governance issues, has been initiated by providing Ways and Means minority staff with a well received conference call briefing on AICPA positions by Exempt Organizations Taxation Technical Resource Panel and the Not-for-Profit Expert Panel members and staff on July 15, 2005. Finally, a conference call with Ways and Means minority staff was held on September 12, 2005 to discuss valuation issues with members and staff from the AICPA BV Team.

"Highway Bill" Letter

The AICPA outlined its concerns about tax provisions in the Senate's version of H.R. 3, the Safe, Accountable, Flexible, Efficient Transportation Act of 2005, in letters to the Senate Finance and House Ways and Means Committees. The letters, which were sent to the chairs of the Senate Finance and House Ways and Means Committees on June 9, 2005, objected to the provisions contained in the Senate bill involving: (1) frivolous tax submissions, (2) the CEO declaration on corporate income tax returns, (3) the economic substance doctrine, and (4) Offers in Compromise. The four proposals were dropped from the final version of the legislation.

Study on Reform of the Estate and Gift Tax System

The AICPA sent a copy of its *Study on Reform of the Estate and Gift Tax System* to Senate Finance Committee members. The study "considers alternatives, including substantial modification and outright repeal of the current transfer tax system, and analyzes each alternative for its probable impact on taxpayer behavior, complexity and compliance, liquidity, redistribution of wealth, tax and succession planning, revenue and transition issues." Suggestions are also offered on each of the alternatives about the best way to achieve simplicity, reduce taxpayer compliance burdens, improve ease of administration and address revenue considerations. Prepared in 2001, the study remains a timely and relevant analysis of the current transfer tax system, as Congress considers various issues and alternatives with regard to a compromise on estate tax reform.

Hearing on Federal Regulation of Tax Preparers

Tax Executive Committee Chair, Tom Purcell testified at a House Oversight Subcommittee hearing on the federal regulation of tax preparers. His testimony focused on the AICPA's positions on: (1) high professional standards for tax professionals, (2) federal legislation that regulates unlicensed tax return preparers, and addresses the enforcement and consumer protection problems associated with the Earned Income Tax Credit and refund anticipation loan programs, (3) exempting CPAs, attorneys and Enrolled Agents from regulation under any new legislation enacted to regulate federal income tax return preparers, (4) Congressional review of the current Electronic Return Originator application process and how that process might overlap even a "limited" registration process for federal income tax return preparers and (5) ensuring that the persons subject to any preparer registration initiative be the persons who bear the cost of the new program, and not those tax professionals already subject to Circular 230.

TAX ISSUES

Disaster Assistance, Including Hurricane Katrina

- The *Disaster Area Practice Guide* was updated to reflect guidance for victims of Hurricane Katrina. The guide covers practical tax issues for CPAs and includes links to IRS forms and publications.
- Staff has met with IRS personnel to discuss how to mitigate the problems hurricane victims will face in meeting their filing, payment and other compliance obligations, including extending filing and payment deadlines beyond October 31, 2005, expediting casualty loss-related refund payments, automatically abating penalties and interest, creating exceptions to IRS documentation procedures for proofs of casualty losses and establishing IRS taxpayer assistance centers at the disaster sites and where victims have relocated.
- Together with many other AICPA Teams, the Tax Division facilitated the completion of an agreement with IRS to partner with the AICPA to provide assistance to taxpayers at local disaster recovery centers established by the Federal Emergency Management Agency (FEMA).

BV Standards

- Tax Division members and staff have assisted the BV Standards Team in reviewing the tax-related comments received on the SSVS exposure draft and modifying the tax “questions and answers” based on the feedback. The Division has also been involved as a resource in responding to concerns about the standards and their impact on tax practice.
- The Tax Executive Committee worked collaboratively with the BV Team in supporting the SSVS exposure draft that was released last March. The TEC is expected to discuss and vote on an updated proposal later this Fall.

Senate Permanent Subcommittee on Investigations

The Division has been in contact with the staff of the Senate Permanent Subcommittee on Investigations, which released a report on tax shelter activities (The Role of Professional Firms in the U.S. Tax Shelter Industry) earlier this year. The AICPA submitted a “positively-slanted” letter to the subcommittee’s ranking members, which also touched on AICPA ethics-related initiatives. In addition, David Lifson and Harvey Coustan, co-chairs of our Tax Shelter Issues Task Force, met with subcommittee staff.

TAX ISSUES

House Hearing on the Tax Gap

Ron Hegt, a member of the Tax Executive Committee, testified before the House Small Business Committee at their hearing on "closing the tax gap and its impact on small businesses." The AICPA testimony focused on (1) tax law simplification and (2) IRS's efforts to increase compliance within the small business community.

Regulatory Interaction with Government

The Division maintains numerous contacts with IRS, Treasury, the Congressional Tax Writing Committees and other governmental/regulatory bodies on various issues on an ongoing basis including:

- Submitting a letter on to the IRS expressing its concerns about Rev. Proc. 2005-24, which provides guidance on spousal election rights and charitable remainder trusts under Internal Revenue Code section 664.
- Submitting comments to IRS on the proposed amendments to the 401(k) and (m) regulations, providing guidance on designated Roth contributions.
- Meetings with the IRS to discuss the temporary and proposed regulations on mandatory e-file for large corporations.
- Meeting with the Mitre Corporation to discuss their study on behalf of the IRS regarding the establishment of an information return clearinghouse. The clearinghouse would be available for dissemination of information return data to the IRS, Social Security Administration, banks, states, financial institutions, etc.
- Providing testimony at a Multi-state Tax Commission (MTC) hearing on its proposed model statute that requires taxpayers to add back certain intangible and interest expenses paid to related parties. The Division also submitted more detailed written comments on August 31, 2005.
- Submitting comments on the proposed amendments to the section 415 regulations relating to guidance for plan administrators to determine section 415 limitations regarding post-severance compensation.
- Providing feedback to AcSEC on their comment letter submitted to FASB relating to a FAS 109 exposure draft regarding Uncertain Tax Positions.

BANK REGULATORY RULEMAKING ON AUDITOR INDEMNIFICATION

The Federal Financial Institutions Examinations Council (“FFIEC”) requested comments on guidance on the use of liability limitation provisions in auditing engagement letters used with insured financial institutions (see www.ffiec.gov, go to Press Releases, and then go to the May 10, 2005 press release). The proposed rule would prohibit insured financial institutions from retaining an auditor where the audit engagement letter limited the liability of the auditor. This includes provisions that would require certain alternative dispute resolution provisions or would limit punitive damages.

The AICPA’s Professional Ethics Executive Committee and the AICPA’s Depository Institutions Expert Panel jointly drafted a comment letter to the FFIEC, as did others, including accounting firms. All comment letters, including the AICPA’s comment letter, can be viewed through a link at the FFIEC website shown above.

We are currently awaiting the FFIEC's decision on the final rule.

AICPA Staff Contact:

Peter M. Kravitz, Director, Congressional & Political Affairs, PKravitz@aicpa.org, 202/434-9218

GRAMM LEACH BLILEY ACT PRIVACY ISSUES

Issue and Background

The Gramm-Leach-Bliley Act requires "financial institutions" to make certain annual disclosures to their consumer customers regarding non-public personal financial information. Congress found that "each financial institution has an affirmative and continuing obligation to respect the privacy of its customers and to protect the security and confidentiality of those customers' non-public financial information."

To define a "financial institution," Congress looked to the bank holding company regulations issued by the Federal Reserve Board. These extremely broad regulations, which define permissible activities for bank holding companies, define tax preparation services for consumers (e.g., income tax, estate tax, gift tax, etc.) as financial in nature, and thus permissible activities for bank holding companies. Thus, CPAs who are substantially engaged in such activities are subject to the privacy disclosure provisions of GLB.

AICPA Position

CPAs have historically been legally required to maintain the privacy of all non-public financial information provided to them by a client. CPAs are subject to mandatory rules of confidentiality and risk losing their ability to practice their profession if they disclose non-public personal financial information without the express consent of their client. These confidentiality provisions arise from State CPA licensing laws and regulations. In addition, the Internal Revenue Code imposes a penalty, which can include criminal liability, on federal income tax return preparers for disclosing information given to them to prepare a return or who uses such information for any purpose other than return preparation without express permission.

The GLB annual disclosure requirements impose a substantial unnecessary regulatory burden on CPAs, and especially on sole practitioners and small firms. The purpose of GLB was to protect the confidentiality of non-public personal financial information by requiring disclosure of how that information may be shared, and allowing the customer to "opt-out" of any information sharing. For CPAs, there are currently requirements that give greater protection – customer opt-in for any sharing of the non-public financial information – than provided for in GLB.

GRAMM LEACH BLILEY ACT PRIVACY ISSUES

Action Requested

Please support H.R. 2387, the Privacy Protection Act of 2005, introduced by Mark Kennedy (R-MN) and Rep. Collin Peterson (D-MN). This legislation would exempt CPAs from being required to give meaningless annual disclosures to their clients. It is expected that a version of this bill will be offered by Congressman Kennedy as an amendment to H.R. 3505, the banking regulatory relief bill, which contains other GLB provisions and may move this Congress.

AICPA Staff Contacts

Peter M. Kravitz, Director, Congressional & Political Affairs, pkravitz@aicpa.org, 202/434-9218

William Stromsem, Director, Taxation, bstromsem@aicpa.org, 202/434-4227

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 Toolkits (Corporate, Not-for-Profit and Government), 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 Corporate Audit Committee Toolkit was sponsored by grants from CNA Insurance Company and the AICPA Foundation. It was developed for widespread distribution in the public interest.
- At this time, over 40,000 copies of the Corporate Organizations 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.
- Toolkits for Not-for-Profit Organizations and Government Organizations were recently made available online for free download. Printed copies of these Toolkits will be available September 29th.
- 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. It also includes guidelines for executive sessions, and for evaluation of the internal audit function, external auditors and the audit committee itself.
- A new tool for audit committees receiving adverse opinions under Sarbanes-Oxley section 404 was released early this summer. E-alerts were also issued apprising companies of the PCAOB approval of AS4-Reporting on Whether a Previously Reported Material Weakness Continues to exist and final rules regarding auditor independence and tax services.
- 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 2,000 of our members have registered on the Matching System. Recent activity has been approximately 50 searches per month.

COSO Releases 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.

COSO Releases Enterprise Risk Management – Integrated Framework

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?

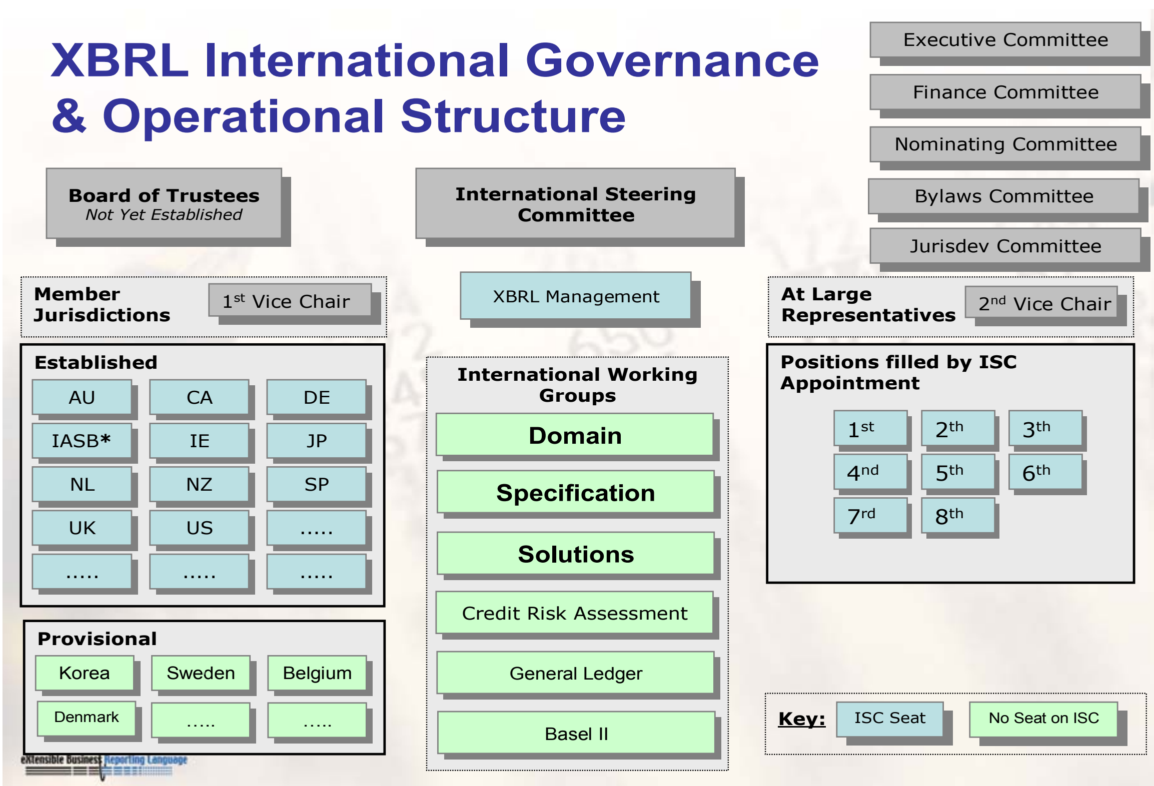
- XBRL is a language for the electronic communication of business and financial data. It provides major benefits in the preparation, analysis and communication of business information. It offers cost savings, greater efficiency and improved accuracy and reliability to all those involved in supplying 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.

XBRL

- 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.

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

XBRL

How do companies create statements in 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.

PCAOB PROPOSED INDEPENDENCE RULES – TAX SERVICES

- The PCAOB's proposed rule on independence and tax services was released December 14, 2004 with a comment period deadline of February 14, 2005
- An AICPA comment letter was issued on CPCAF letterhead signed by CPCAF, PEEC and TEC Chairs

<u>Tax Services Permitted Under the Rule</u>

- Routine Tax Return Preparation and Tax Compliance
- General Tax Planning and Advice (except for aggressive strategies)
- International Assignment Tax Services
- Employee Personal Tax Services (except financial officers)

<u>Contingent Fees</u>

- **Proposed Rule 3521** is comparable to a recent SEC position in that it prohibits contingent fees
    - Fee would not be considered contingent if the amount is fixed by courts or other public authorities and not dependent on a finding or result, **however**
    - Does **not** provide exception for substantive consideration by taxing authority in a way consistent with the current AICPA rule.
- **AICPA comment letter** will not challenge prohibition

<u>Treatment of a "listed" transaction</u>

- **Proposed Rule 3522(a)** prohibits planning, or opining on the tax treatment of, a listed transaction
    - Refers to IRS definition of "listed transaction"
- **AICPA comment letter** will
    - State that we generally support the rule
    - request clarification in a number of areas
    - express concern that PCAOB might consider independence impaired if transaction becomes listed after it is executed

PCAOB PROPOSED INDEPENDENCE RULES – TAX SERVICES

Treatment of a "confidential" transaction

- **Proposed Rule 3522(b)** prohibits planning, or opining on the tax treatment of, a confidential transaction
- **AICPA comment letter** will not challenge prohibition

Aggressive Tax Positions

- **Proposed Rule 3522(c)** prohibits planning, or opining on the tax consequence of, a transaction that satisfies three criteria –
  - the transaction was initially recommended by the firm or another tax advisor;
  - a significant purpose of the transaction is tax avoidance; and
  - the proposed tax treatment of the transaction is not at least more likely than not to be allowed under applicable tax laws.
- **AICPA comment letter** will not challenge prohibition
  - Will request clarification on a number of items including the scope and meaning of "initially recommended

Tax Services for Senior Officers

- **Proposed Rule 3523** prohibits tax services to an officer in a financial reporting oversight role at the audit client
- *Financial reporting oversight role* is position to exercise influence over the contents of the financial statements or anyone who prepares them
- **AICPA comment letter** will ***not*** support the rule
  - Conceptual issues, cascade concerns, highlight benefits of providing certain tax services to officers
  - Firm should be able to provide *permitted* tax services to senior officers

Persons Associated with the Firm

- **Proposed Rule 3502** prohibits associated persons from causing firm to violate the Act due to an act or omission *the person knew or should have known would contribute to such violation*.
- **AICPA comment letter** will challenge and ask for clarity

PCAOB PROPOSED INDEPENDENCE RULES – TAX SERVICES

Audit Committee Pre-Approval

- **Proposed Rule 3524** requires that in seeking pre-approval of permissible tax services, the firm shall provide the audit committee with:
    - A robust engagement letter
    - Info on any compensation arrangement with respect to promoting, marketing, or recommending a transaction covered by the service
- The firm must conduct and document a discussion with the audit committee about the potential effects of the services on the independence of the firm
- **AICPA comment letter** will request clarification and further guidance in a number of areas

Effective Date

- The new rules are effective on the later of October 20, 2005, or 10 days after the date that the SEC approves them.
- **AICPA comment letter** will recommend that the effective date allow for:
    - The provision of follow-up tax services (e.g., representation during IRS audit) for senior officers if related to tax services rendered prior to the effective date
    - Transition period to allow for the completion of tax services for employees who are promoted into a financial reporting oversight role

SOCIAL SECURITY REFORM

- The CPA profession believes the long-term viability of the Social Security system must be addressed. Societal, economic and workforce changes call into question the role, design and objectives of the program over the next century.
- The AICPA continues to monitor the Social Security reform debate, discussion of the impact of privatization and the necessity to raise taxes.
- In May 2001, President George Bush established the President's Commission to Strengthen Social Security. The bipartisan Commission was charged with studying and reporting "specific recommendations to preserve Social Security for seniors, while building wealth for younger Americans." It was the establishment of this Commission and its report in December 2001 that triggered a sweeping national debate about the current Social Security system and ways to reform it, including President Bush's proposal to establish voluntary personal accounts.
- In March 2005, the AICPA released "Understanding Social Security Reform: The Issues and Alternatives," a revision of a 1998 study of Social Security reform proposals. The AICPA collaborated with a group of leading CPAs, tax specialists and economic analysts to develop the study. The goal of this study is to provide unbiased facts and analysis to the reader and to foster informed discussion. It will be through such discussion that creative and fair solutions will be found. The study can be found on the AICPA Web site at: www.aicpa.org/members/socsec.htm.
- In August 2004, the Texas Society of CPAs' Executive Board passed a resolution and issued a white paper, *Securing America's Future Economy* (SAFE). The resolution and white paper called on the CPA profession and individual CPAs to encourage elected officials to take action now to implement reforms that would ensure the continued fiscal health of Social Security and Medicare. This would prevent passing a massive financial burden to future generations. The Texas resolution and white paper are available on the Web at:

  http://www.tscpa.org/pressroom/2004/SocialSecurity.asp.
- In November 2004, a number of state CPA societies met to discuss working cooperatively on this issue and since that time a number of states have adopted resolutions supporting Social Security reform. Among those state societies are: Arizona, Arkansas, Massachusetts, Michigan, New Jersey, New York, North Carolina, Ohio, Oklahoma, Oregon, Rhode Island, Pennsylvania, South Carolina and South Dakota.

SOCIAL SECURITY REFORM

- The CPA profession can contribute significantly to the reform discussion. As financial professionals who serve the public trust, CPAs are known for their unbiased and independent analysis of complex financial issues. The CPA profession can provide insightful guidance to educate the public and public policy makers about the size and seriousness of the Social Security issue, reform proposals and their impact upon the economy and tax implications.
- Currently, initial benefits are set by a complex formula that calculates workers' average annual earnings in their 35 highest paid years and adjusts those earnings up from those years to reflect standards of living near that worker's retirement age. That adjustment is based on wage growth over that time span. However, under proposals in the President's Commission report, the adjustment would be based on the rise of consumer prices.
- According to Social Security Administration's estimates, the Social Security Trust Fund balance will peak in the year 2028. By 2042, estimates are the Trust Fund will be exhausted and benefits will be reduced to the then current cash flow into the system. If no changes are made, that cash flow would require a reduction in benefits by 27 percent.
- The debate surrounding Social Security reform brings to the forefront philosophical differences, varying opinions about impact and the age-old trade-offs between fairness, simplicity, economic growth and social policy. Options for reform have a far-reaching effect on all Americans. Current and future beneficiaries must understand the implications of reform in order to reach a consensus and for a new system to gain broad acceptance.

HURRICANE KATRINA RELIEF EFFORTS

- All of us at the feels over the devastation caused by Hurricane Katrina. Our hearts go out to the hundreds of thousands of Americans, whose lives have been forever changed, including the thousands of AICPA members and their families living in areas affected by this disaster.
- The CPA profession has responded to this crisis in a very decisive way. We are determined to bring to bear our expertise regarding financial matters to help victims. The AICPA has also launched a number of initiatives to support our members in this extraordinary time.

One Central Resource

- The Institute has established a central, online Disaster Recovery Resources Center, which is the comprehensive source for all our efforts. We are recommending that members visit the site frequently for up-to-date information, useful links to other Web sites and a wide range of practical tools on this topic.

Firm Volunteer Center

- The most significant resource in terms of providing some help to the CPAs affected by Hurricane Katrina is the establishment by the Institute's Private Company Practice Section (PCPS) of a Firm Volunteer Center.
  - Hundreds of firms across the country have signed on to offer assistance with housing, office space, office supplies, technology support, hosting of email servers, help with critical filings, support in reaching clients and even temporary employment to Louisiana, Alabama, Florida and Mississippi CPAs.
  - CPAs seeking help may go to the Firm Volunteer Center at: http://pcps.aicpa.org/Community/Hurricane+Katrina.html and search for contact information on firms offering the particular assistance they need.
  - CPA firms interested in volunteering should visit the site and complete a brief form indicating which forms of assistance they would like to offer.

HURRICANE KATRINA RELIEF EFFORTS

Helping the Public

- Our profession is also stepping up in the public interest with a number of initiatives that directly help the victims of Katrina.
- The AICPA has re-positioned the "Ask the Money Doctor" program on our 360 degrees of financial literacy Web site to address issues specific to disaster recovery and to help those Americans impacted by the hurricane. Through "Ask the Money Doctor," CPAs and CPA/PFS members across the country are available to answer questions on financial recovery issues from individuals affected by the disaster.
- The AICPA, several state CPA societies and the IRS have joined forces to provide assistance to taxpayers at local disaster recovery centers established by the Federal Emergency Management Agency (FEMA). CPA volunteers in these **pilot** states will soon join IRS employees to staff disaster recovery centers servicing some of the areas affected by Hurricane Katrina. After the pilot is complete, the AICPA and IRS hope to expand the program to other states to help prepare for disaster relief.
- *Disaster Recovery: A Guide to Financial Issues* was developed by the AICPA PFP Team to help individuals and families in the days, weeks and months following a disaster when they are most in need and often vulnerable to financial challenges. The guide is distributed by participating local chapters of the American Red Cross. The kit focuses on the pro-bono services CPAs can offer in moments of crisis and includes a press release template, byline article and PowerPoint presentation.
- As it did after the Asian Tsunami disaster, the Institute has not only provided links and phone numbers of relief agencies on its Web site, the organization has also agreed to match AICPA employee contributions to certain relief organizations.
- The Institute's Tax Section's Disaster Area Practice Guide is also available. It has just been updated to reflect guidance for victims of Hurricane Katrina and includes links to important IRS and other tax-related disaster recovery resources.

HURRICANE KATRINA RELIEF EFFORTS

Other Help for CPAs

- The Institute has issued two new Technical Practice Aids subsequent to the Katrina disaster.
  - The first outlines **the auditor's responsibilities when a natural disaster affects an audit client's operations subsequent to the end of audit field work**, but prior to the issuance of the financial statements and auditor's report.
  - The second identifies certain issues that may arise in **accounting for losses from natural disasters,** and lists relevant accounting literature for non-governmental entities to consider in addressing those financial reporting issues.
- The AICPA and NASBA sent a joint letter to all state boards of accountancy requesting that they expedite practice privilege requests from CPAs and firms that have been affected by Hurricane Katrina and are seeking to practice in their state during their recovery period. Numerous boards of accountancy have already contacted NASBA to report that they have plans in place to facilitate requests and/or are planning to meet to discuss this initiative. The AICPA has also compiled state licensing information to be used for those licensees that are seeking practice privileges in other states, including state board of accountancy and state CPA society contact information.
- The Institute has also developed a checklist to help CPA financial executives navigate through the complicated task of disaster recovery. The checklist outlines the issues that need to be addressed including ensuring employee safety, maintaining operations and evaluating the company's financial situation.
- Please make sure to check the AICPA Disaster Recovery Page at https://www.aicpa.org/news/2005/disaster_recovery_resources.htm, which is updated regularly.

AICPA RELOCATION PROJECT

- The Governing Council of the AICPA has approved a decision to relocate select operations of the AICPA to Durham, North Carolina. Impacted teams are predominately located in the New Jersey office. With a few exceptions, the New York and Washington, D.C. offices will not be impacted by this move.
- Earlier this year, the management team began an analysis of the possibility of a move. The project team was directed to carefully balance the financial benefits of a move, with a focus on maintaining quality membership service and minimizing service disruption.
- The business decision to pursue a relocation project was driven largely by the continuing escalation of the cost of labor in the NY metropolitan area, as well as by the existence of excess space in the New Jersey location due to previous operational changes and subsequent reduction in head count.
- The relocation is expected to provide the AICPA with an annuity savings of approximately $10-11 million dollars per year over a 15 year period, with a total NPV savings over that time of $103 million.
- We recognize that the relocation proposition is a complex one, and like all such moves, accompanied by risks. However, we believe that the business case for moving these operations out of one of the highest salary and real estate market in the United States and into one in which long-term savings are expected to ultimately equal approximately $900,000 per month is compelling.
- The move will take place in phases, with the earliest impacted teams to be relocated in August 2006. By August 2007, we anticipate that all the impacted areas will be located in Durham.
- All business moves involve a degree of disruption to processes and service. The AICPA management team recognizes that other than fiscal responsibility, no other factor is as critical as maintaining the ongoing service to members. To mitigate the risk of service disruption, the AICPA will:
  - Hire a highly qualified and experienced project management firm to ensure the effectiveness of the planning and execution of the relocation.
  - Commit to a minimum of three months of redundant operations for impacted functions.
  - Hire new talent in the selected location immediately.
  - Place a moratorium on new initiatives that are not critical to the welfare and interests of the profession
  - Realign all current commitment and projects to ensure that the organization is positioned to execute successfully.

BUSINESS VALUATION STANDARDS

History:

- The Consulting Services Executive Committee gave approval in 2000 for a Task Force of the BV Committee to begin drafting BV standards.
- A draft of these standards was exposed to “friends and family” (includes all BV competitors, all ABV Credential Holders, IRS, PCPS, Tax Executive Committee, Forensic & Litigation Committee and the ASB) in September 2002 and July 2003.
- The draft was further shared with BV practitioners for input prior to official exposure in draft at the AICPA BV Conference in ’02, ’03 and ’04.
- Given the complexity of the tax issues, a joint task force was formed by the BV Committee and Tax Executive Committee in Fall 2004. The task force worked to resolve all open issues raised by the Tax Executive Committee and to draft Q&A guidance (to clarify how and when the standards would apply to tax practitioners.)
- On January 20, 2005 The Tax Executive Committee formally approved the exposure draft of the Business Valuation Standards.
- The Tax Executive Committee supports the standards for those who provide substantive valuation services because they understand the needs of the BV practitioners, the importance of ethics and principles in maintaining the stature of the profession, and the need to ensure that competent valuation services are provided.
- The standards are intended to provide exclusions for mechanical computations, situations for where the value is provided by the client or a third party and estimates using hypothetical values or in a theoretical discussion in the context of planning.
- There is also a jurisdictional exception in the standard effective when a specific method or formula of valuation or reporting requirement is prescribed by a government, judicial, or accounting authority.
- Prior to exposure in March 2005, a final opportunity for review was provided to by the Business & Industry Executive Committee, Tax Executive Committee, Forensic & Litigation Committee, ASB and PCPS.

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- The Exposure Draft went through all of the appropriate levels of AICPA review prior to issuance.

- During the original official exposure period which began on March 30, 2005, the AICPA received many comment letters or phone calls from tax practitioners which indicated that they were just beginning to understand the impact of the BV Standards Exposure Draft on their practices primarily because the beginning of the period coincided with tax season.

- As a result, the Consulting Services Executive Committee approved extending the exposure period through September 30, 2005.

- We have had an extensive communications plan to announce the exposure period that included all traditional AICPA vehicles, State Societies, Major Firms conference, specific announcements by the Tax Division, B&I, PCPS, Accounting & Auditing, BV/FLS, and PFP to its members, State Society BV/FLS Committees, and other non-traditional external methodologies (including legal journals and through competitive organizations).

- In extending the exposure period to September 30, 2005, we communicated to the same audiences multiple times and also communicated specifically to the Tax trade press, State Tax and Audit Committees (through the State Society Executive Directors), and State PFP Committees. All of the 161 comment letters that have been received are also posted on the AICPA BV/FLS web site.

- The joint Tax/BV working group met several times during the exposure period to analyze comments and issues related to tax.

- The Tax Executive Committee was briefed on October 31st on the status of the document. A joint Tax/BV panel also made a presentation to the Fall Tax Division Conference to gain additional input from that constituency.

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Summary of Major Concerns of Tax Practitioners

- The AICPA does not set standards for member segments. We set standards based upon the performance of specific services unless there is an exception provided. Accordingly, if you are a tax practitioner doing a business valuation, you need to comply with these standards.

- The BV Standards do articulate circumstances in which the valuation standards do not apply (e.g. Mechanical Computations) and exceptions from the reporting requirements for certain litigation support engagements.

- The Business Valuation Standards do not conflict with the Statement on Standards for Tax Services (SSTS), but they do overlap. The TEC and BV Committees are addressing the need for appropriate member guidance when the standards are issued in final form.

- There are concerns that the standards are not meaningful for tax practice, particularly as to the suggested report language in the original exposure.

    - The Tax Executive Committee and the BV Committee have agreed to allow Oral Valuation Reports in principle for all practitioners in the final standards.

- Tax practitioners are advocates for their clients. BV practitioners calculate their valuation conclusions objectively. Does this create an irreconcilable difference?

    - The Tax/BV Task Force will review and conclude on this item at its December 13-14, 2005 meeting.

- A preliminary conclusion has been reached on this issue. The Tax/BV task force will conclude on Small Case or Deminimus Exception at its December 13-14, 2005 meeting.

BUSINESS VALUATION STANDARDS

Next Steps:

- On December 13-14, 2005, the joint Tax/BV task force will meet again to review the standards as they have been updated to reflect exposure comments. They will finalize all outstanding issues (including Advocacy/Objectivity and Small Case Exception.)

- Subsequent to this meeting the standards will continue through the established standards process. A review opportunity of the revised document will be afforded to the Business & Industry Executive Committee, Forensic & Litigation Committee, ASB, and PCPS along with the Tax Executive Committee.

- The Tax Executive Committee will review all changes to the standards and analyze the issue of a general tax exception at its February 2006 meeting.

- The Consulting Services Executive Committee has decided to re-expose the standards after the 2006 tax season for a short exposure period.

- The effective date for the standards will no longer be January 1, 2006. The revised effective date will be determined in conjunction with the next exposure period.