

February 16, 2004

To our clients and friends:

Our SEC Team Principals have recently returned from the AICPA National Conference on Current SEC Developments. The conference was held in Washington, DC on December 10 – 13 and included speakers from the SEC, PCAOB, FASB and other regulatory and standard setting bodies, as well as over 2,000 participants. To keep you informed of current regulatory developments, we have prepared a recap of the highlights of the conference.

The keynote speaker, **S. Scott Voynich**, Chairman of the American Institute of Certified Public Accountants, opened the conference with a message of “change:”

It has been a challenging year – a year of change. Companies and audit firms have had to meet a series of challenges. It has been a year of establishing strengthened corporate governance systems, including enhanced audit committee roles, responsibilities, qualifications and independence; a renewed focus on management’s responsibilities regarding monitoring adherence to ethics, policies, and certifications. A year of enhanced internal controls and reporting. A year of demands for greater transparency and disclosures, and accelerated deadlines.

Of course, change means many new responsibilities being placed on the shoulders of auditors, preparers, standard setters, and regulators. Overwhelmingly, you have addressed these new responsibilities with commitment, hard work, and integrity.

I saved integrity for last because it is the most important. It is integrity that provides a sense of shared purpose to a very diverse profession. As a profession, we need to put our sense of integrity into action.

Integrity in action includes the definition that is key to our profession – a rigid adherence to a code of behavior. We are expected to live by a code of ethics. It must serve as the North Star for all of our activities.

These are the essential elements of integrity – ethics, completeness, unity. These aspects of integrity must be behind every endeavor as we work to refocus and reposition the AICPA. It is not enough to embrace change – we have to drive it.

Voynich described a number of initiatives the AICPA has underway to drive change:

- An on-line **Audit Committee Matching System** at www.aicpa.org to help companies that are finding it difficult to recruit qualified members for their audit committees.
- A 136 page **Audit Committee Toolkit** – www.aicpa.org/Audcommctr/toolkits/homepage.htm - that helps members of audit committees get to the heart of the audit issues they should be addressing.
- A **multi-faceted anti-fraud program**, the brainchild of the AICPA and the Association of Certified Fraud Examiners. It includes an Institute for Fraud Studies at the University of Texas at Austin. The AICPA and the Federal Bureau of Investigation are also collaborating to stamp out corporate fraud.
- **The Center for Public Company Audits**, which Voynich characterized as “the voice for the collective profession in our nation’s capital.” The Center will serve as a guide for auditors of SEC registrants to help them meet the requirements of the Sarbanes-Oxley Act.
- A **Special Committee on Enhanced Business Reporting**, which evolved out of the AICPA’s belief that investors are entitled to more transparent and timely financial information. The committee is working to establish a consortium that would bring together the investment and lending community, government, public and private companies, software developers, academia, and accounting firms – all with the goal of improving the quality and transparency of information used for decision making. The consortium is scheduled for launch in 2004.

The highlight of the conference was a presentation by **William J. McDonough**, the Chairman of the Public Company Accounting Oversight Board. In his opening comments, Mr. McDonough spoke of the PCAOB’s objective:

Our objective is to help auditors find a new direction that will lead to the restoration of public confidence in auditing and in our markets. We must have an end to bending rules – and principles – and return to a single-minded emphasis on presenting information fairly. The public needs a basis for confidence that those who invest in the financial markets will be treated fairly by the participants. You are the key to that confidence.

The Chairman also commented on the new requirements of the Sarbanes-Oxley Act, which have been criticized by some auditors and issuers for being burdensome and costly:

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Instead of thinking of Sarbanes-Oxley as a long checklist of new requirements, you should think of it as a new source of strength. We're going to have to work on developing and maintaining this strength. Accountability – not just to investors, but to the public at large – is what we must be about. Seldom have the stakes been higher for our markets.

As for his expectations as PCAOB Chairman, Mr. McDonough stated:

I approach my new job as Chairman of the PCAOB as I approached my job as the top bank supervisor at the New York Fed. I expect the public-company auditors that we supervise to know what the rules are. I expect that they are following those rules, both in their letter and their spirit. I bring those expectations, and the respect they engender, to the table when I deal with you as Chairman of the PCAOB.

In closing, Mr. McDonough reiterated the importance of restoring confidence in investors through the integrity of public audits:

What's at stake for all of us is the trust of the American people in our markets and the companies that drive our economy. We have an opportunity to reclaim that trust. I, for one, am delighted to grab that opportunity. I hope you will join me.

Another much anticipated speaker, **Robert H. Herz**, Chairman of the Financial Accounting Standards Board, discussed progress made towards international convergence:

When one thinks about global capital markets and international convergence, there are many other key players. In the area of accounting standards, the International Accounting Standards Board (IASB) is the key player. And, of course, the FASB and the IASB have been working actively together over the past couple of years in pursuit of international convergence of accounting standards.

We have been working together on several joint projects including purchase method procedures for business combinations, on the pervasive subject of revenue recognition, and on eliminating specific areas of difference in our existing standards through what we have dubbed "short-term" convergence projects. We are also working in parallel on the important projects including stock-based compensation and reporting on financial performance. Our goal in each of these areas is to end up with common or substantially converged standards to the maximum extent possible.

Also presenting was **Donald T. Nicolaisen**, Chief Accountant of the SEC, who emphasized the renewed importance of the relationships between the auditor, the audit committee and management:

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The Act also places the audit committees of public companies front and center. It is certainly a new day for audit committee members and other board members, who, more clearly than ever before, are recognized as shareholders' representatives. One of the most important objectives for audit committees is to strengthen their oversight of both the external auditor and management. The relationship between the committee, management, and the external auditor should evolve to one where the expectations of the audit committee are well established and where management and the external auditor are particularly responsive to those expectations.

The Act places new responsibilities on audit committees to engage the independent auditor and to deal directly with the auditor on significant matters related to the company's financial statements. The audit committee should expect that the auditor will approach his or her role with an attitude of professional skepticism, tempered with experience. There should be open lines of active, substantive, and brutally honest communication. The audit committee should be the external auditor's biggest fan and harshest taskmaster.

The relationship between management and the audit committee is equally important. At the broadest level, the ability of the audit committee to assist management in establishing the proper tone at the top is of utmost importance. In addition, audit committees require more information than before to fulfill their mandated and fiduciary responsibilities.

In addition to working with auditors, audit committees are facing an enormous amount of change in other areas. For this year-end, many companies will be impacted by new consolidation and disclosure guidance issued by the FASB in FASB Interpretation 46. And the effective date of the Section 404 rules, which set in place new reporting requirements with respect to internal controls over financial reporting, is just around the corner for large companies. I would encourage audit committees to have regular meetings with management and their auditors to assess the status of the company's preparation and progress in adopting new accounting principles, governance and disclosure requirements, and internal control processes.

Mr. Nicolaisen had this to say about the highly scrutinized FIN 46, *Consolidation of Variable Interest Entities*:

We have supported the basic principle contained in the interpretation, which is that the financial results of what FIN 46 describes as a variable interest entity should be consolidated with the financial statements of the company that is the primary beneficiary of that entity. The adoption of FIN 46, including disclosures, is something we will be looking at closely, not just because of its importance to investors, but also because we will be reporting to Congress next year on off-balance sheet matters, and that report will be influenced by the quality of your filings and disclosures.

The Chief Accountant also commented on the Sarbanes-Oxley Act and its cost to smaller public companies:

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During the comment periods for Sarbanes-Oxley Act rulemaking, the SEC received many comments focusing on the increased burden that the proposed rules would place on smaller-sized public companies. Some additional costs are inevitable. However, the burden to smaller companies can be disproportionate and needs to be appropriately weighed against the protection of investors. This balancing act is something that the SEC staff will continue to monitor as the ramifications of the Sarbanes-Oxley rules become evident, and we will recommend adjustments to our rules if unintended consequences arise. It is also an important consideration for the FASB and the PCAOB. We all need to strike a balance.

Mr. Nicolaisen added this suggestion regarding cash flow statements:

Preparers may want to consider another financial reporting change in the near term. I've heard many investors express a strong preference for use of the direct method of preparing the statement of cash flows. It's widely understood and believed by many to be a more informative presentation. We are not requiring a change, but it is an action you could consider to promote transparency given the importance to investors of cash flow information.

The Tauber & Balser SEC Team is dedicated to meeting the needs of SEC registrants. If you have any questions that you would like us to address for this upcoming reporting season, please give one of us a call.

Sincerely,
The Tauber & Balser SEC Team Principals

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