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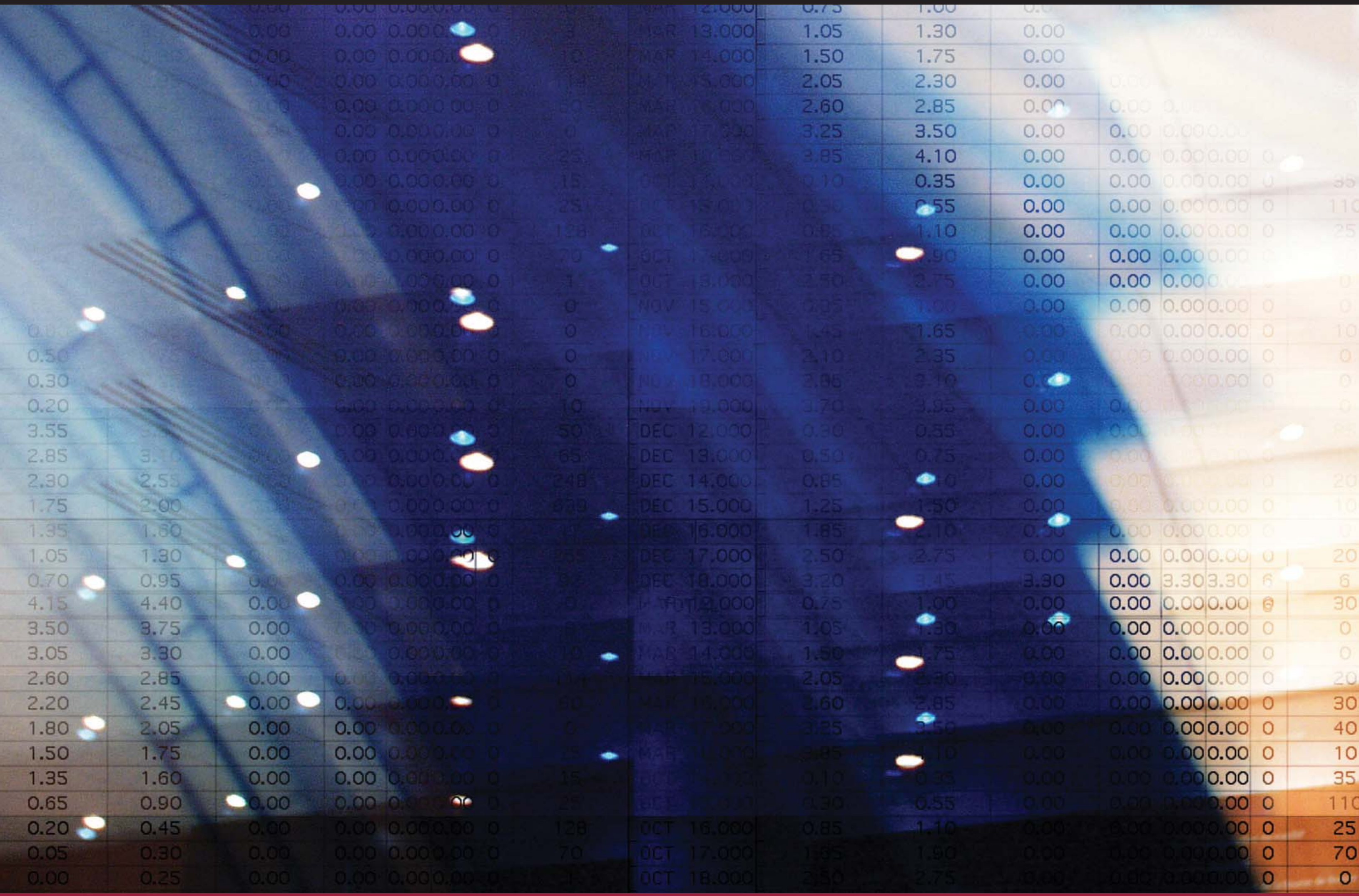

2003 Annual Review of Financial Reporting Matters

Huron Consulting Group is pleased to present you with our *2003 Annual Review of Financial Reporting Matters*.

Sarbanes-Oxley and recent catastrophic restatements have resulted in major changes in our financial reporting world. However, financial reporting problems continue to make headlines in the news, even though internal and external scrutiny plus shareholder demands are working to improve the reporting process.

The *2003 Annual Review of Financial Reporting Matters* takes an in-depth look at the financial reporting world and addresses some of the major events arising in 2003.

Huron's report examines the actions taken by the U.S. Securities and Exchange Commission (SEC), the Public Company Accounting Oversight Board (PCAOB) and the Financial Accounting Standards Board (FASB) and includes our observations regarding the public accounting industry. In addition, our report analyzes the leading causes and trends in financial restatements filed with the SEC for the year ending December 31, 2003.

We hope that you will find the *2003 Annual Review of Financial Reporting Matters* informative and useful. We welcome your comments and feedback, especially as to what additional analysis you would find helpful. Please do not hesitate to contact us to discuss issues raised in the report.

Huron Consulting Group LLC
February 2004

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Restatement Results

"Given that we had a runaway market in the 1990s, you just don't change that type of culture overnight. It takes a while to put the brakes on that train. While it is slowing, investors sure as heck do not want to stand in front of it yet."

Lynn Turner,

Former SEC Chief Accountant

Introduction: Facts about the Database

To identify common attributes and trends in public company accounting errors, we analyzed filings for restated financial statements (10-K/A's and 10-Q/A's) during the five-year period January 1, 1999 through December 31, 2003.

The purpose of our analysis was to gather data on the size and industry of the registrants that experienced a restatement problem and, ultimately, to review the underlying accounting error that necessitated the restatement. We also summarized information on the type of financial statement (annual or quarterly) involved in the restatement.

The procedures we employed in our analysis included:

- Performed a search of all 10K/A and 10Q/A filings in the Edgar database from 1999 through 2003 using the keywords "restate," "restated," "restatement," "revise," and "revised."
- Refined search to include only "restatements" defined as a restatement of financial statements that was the result of an error, as defined in APB 20. Our report excludes restatements due to changes in accounting principles and non-financial related restatements.
- Prepared a database with relevant information for each restatement identified, including the following fields: Company Name, SIC Code, Annual Revenues (from the most recent filing), Footnote Disclosure Describing the Restatement Issue, Classification of Restatement Issue, Restating 10K or 10Q, and Auditor of Record (limited to amended annual financial statements).

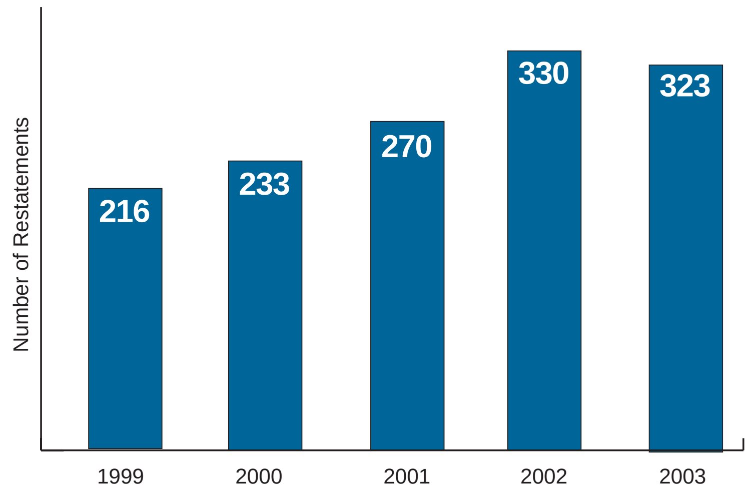
In addition, we applied the following definitions and practices in compiling our analysis:

- Multiple amended filings by a single company for the same underlying purpose were counted as one restatement. If the period being restated included an annual period, the restatement was recorded as a 10K restatement, whereas if only quarterly periods were being restated, it was recorded as a 10Q restatement.
- Restatements are recorded as of the year filed, not when announced. Thus, to the extent that companies announced the need to restate during 2003, but failed to file amended financial statements by December 31, 2003, these companies were not included in our 2003 restatement database. Similarly, some companies announce via an 8-K or press release that the company is going to restate in the near future, but then ultimately do not file amended financial statements with the SEC (e.g., file for bankruptcy or are delisted), and therefore these companies are not included in our restatement database.
- Our process was limited to the information contained in the public filings and did not involve interaction with any of the companies in our database. As such, the interpretation of the accounting changes has not been verified with these companies.

Overall Trends

Public companies that restated their previously released financial statements due to accounting errors totaled 323 in 2003, a slight decline compared to the 330 restatement filings identified in 2002, and up from 270 in 2001 and 233 in 2000. These restatements have been filed in both amended quarterly (10Q/A) and annual (10K/A) financial statements filed with the SEC.

Restatements by Year Filed



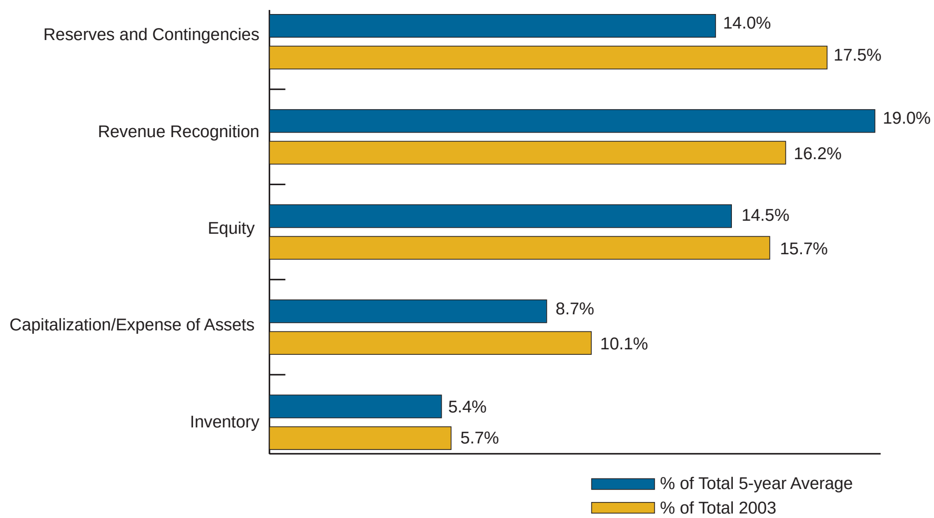
Major Issues, with Definition Table

Errors in accounting for reserves and contingencies was the leading cause of restatements in 2003. This category includes accounting errors related to accounts receivable and inventory reserves, restructuring reserves, accruals, and other loss contingencies. Restatements attributable to this category experienced a greater increase in 2003 than any other accounting issue.

Reserves and contingencies may be the most judgmental accounts in a company's financial statements, because in many cases, they are subject to an estimation process. These restatements, however, do not simply reflect changes in estimates, but rather reflect flawed judgments due to oversight or misuse of facts, fraud, or a misapplication of GAAP.

Revenue recognition was the second leading cause of restatements in 2003. However, the 63 revenue recognition related restatements identified in 2003 represent a 26 percent decrease from 2002 when revenue recognition restatements reached an all time high.

Major Accounting Issues (1999 - 2003)

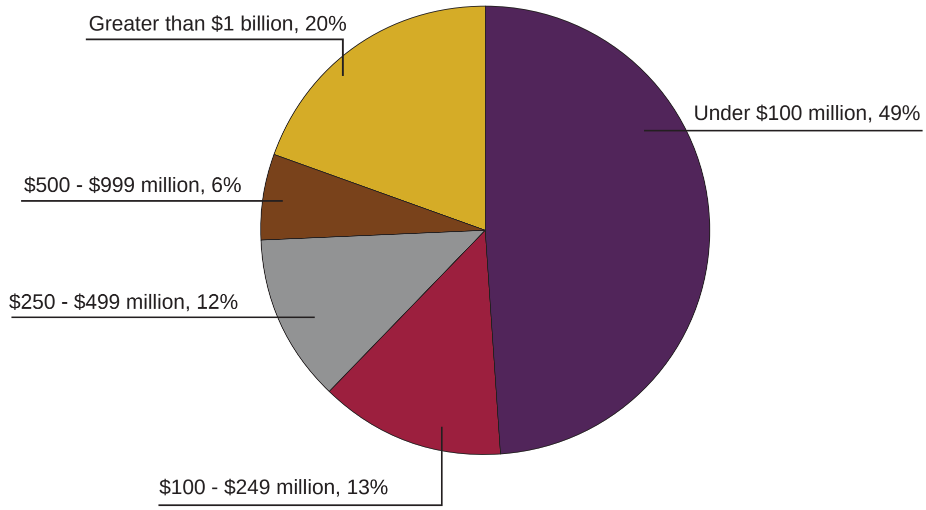


Accounting Issue	Explanation
Reserves and Contingencies	This category includes errors involved in accounts receivable and inventory reserves, restructuring reserves, accruals, and other loss contingencies.
Revenue Recognition	Those instances where the company improperly recognized revenue on transactions.
Equity	This category includes errors involving stock option accounting, EPS accounting, and accounting for warrants and other equity instruments.
Capitalization / Expense of Assets	Instances where a company has improperly capitalized an expenditure that should have been expensed under GAAP (or vice versa).
Inventory	This category includes inventory valuation issues, inventory quantity issues, as well as cost of sales adjustments.

Size

The number of 2003 restatements by companies with annual revenues under $100 million rose to 158, or 49 percent of all restatements filed during the year. The percentage of restatements filed by companies with annual revenues greater than $1 billion decreased slightly in 2003, from 22 percent in 2002 to 20 percent in 2003.

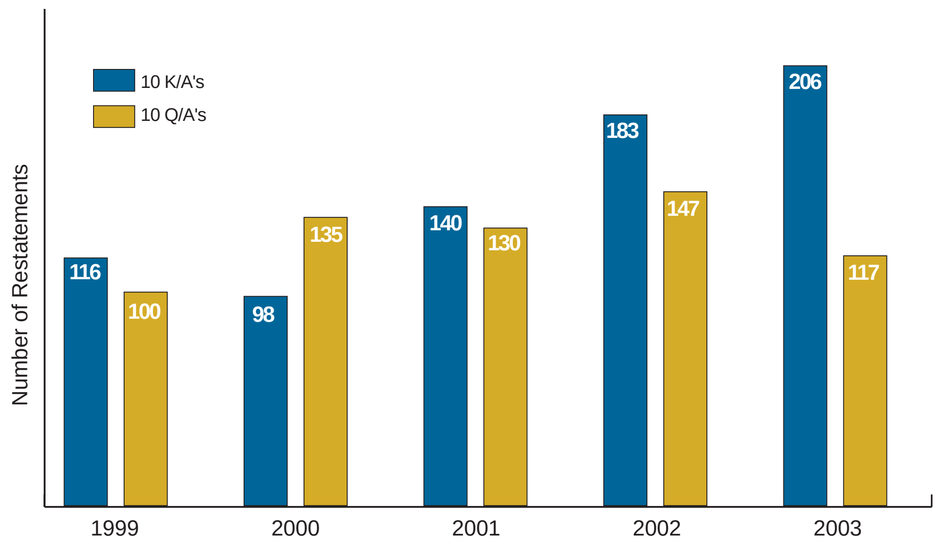
Restatements by Company's Revenue Size (2003)



10 K's

In 2003, the number of filings containing restated audited annual financial statements rose to a record high of 206, representing 64 percent of total restatements filed during the year. While investors rely on both quarterly and annual financial statements of public companies, there is a different level of procedures and responsibility assumed by the auditors for each of these. Annual financials require a higher level of effort and association because an audit opinion is rendered.

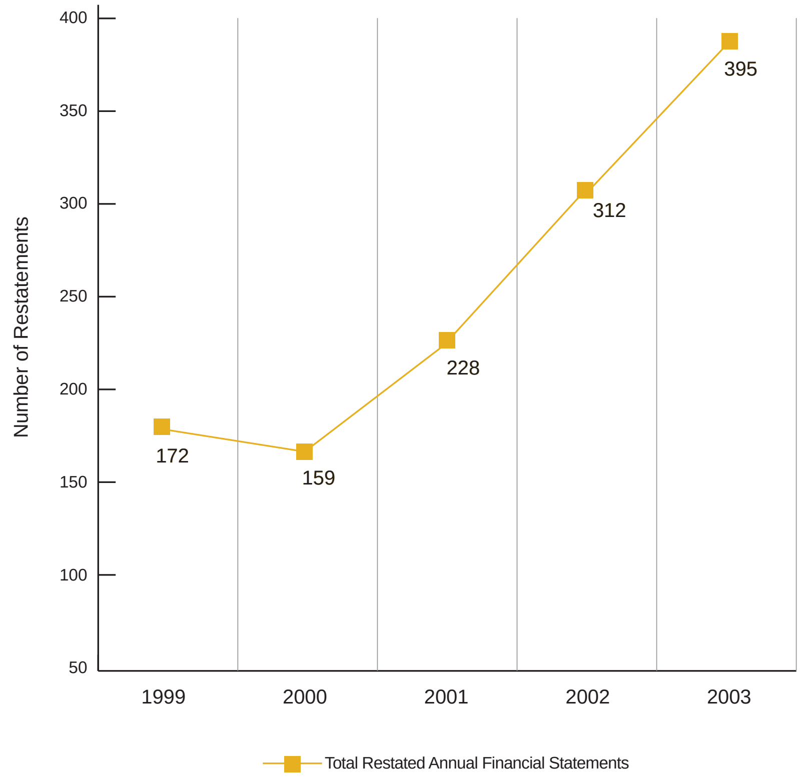
Restatements by Year Filed (10-K/A's vs 10-Q/As)



Trends in Restated Annual Financial Statements

As described earlier, the number of registrants filing 10K/A's rose in 2003 to 206. To identify the underlying number of annual financial statements affected by these errors, we also tallied the gross number of restated annual financial statements included in these filings and observed a similar trend with 395 restated audited annual statements being included in the 206 10K/A filings.

Restated Annual Financial Statements



Regulatory and Rulemaking Authorities

"We must reduce the financial reporting system's reliance on rules and move towards an objectives-oriented system."

Cynthia Glassman, SEC Commissioner

"The SEC staff released its report encouraging standards that are more objectives-based and less rules-based. I embrace the observations of this study."

Donald Nicolaisen, SEC Chief Accountant

"Active state enforcement is critically important because the SEC lacks the resources to uncover every lead and investigate every allegation of misconduct – even with our recent budget increase."

William Donaldson, SEC Chairman

SEC

In 2003, the SEC continued to undergo change. In the aftermath of Sarbanes-Oxley, the SEC's powers and resources have increased and have resulted in a very active year.

"Objectives-Oriented" Standards; SEC Provides FASB with Guidance

Under federal securities laws, the Commission is the ultimate authority on accounting standards for public registrants in the United States. In 2003, the SEC staff recommended that future accounting standards be prepared on an "objectives-oriented" approach. While many have debated the merits of "principle" versus "rule" based financial reporting, the new "objectives-oriented" guidance seems to embrace the principle side of the discussion.

In particular, the SEC staff recommended that future accounting standards possess the following characteristics:

- Be based on an improved and consistently applied conceptual framework;
- Clearly state the accounting objective of the standard;
- Provide sufficient detail and structure so that the standard can be operationalized and applied on a consistent basis;
- Minimize the use of exceptions from the standard; and
- Avoid use of percentage tests ("bright-lines") that allow financial engineers to achieve technical compliance with the standard while evading the intent of the standard.

Although this recommendation specifically addresses prospective accounting standard setting, there also appears to be a strong message that substance matters more than form when reporting business transactions and events.

Jurisdictional Conflict and Concurrent Proceedings

Civil and criminal actions for misconduct in the financial markets have been coming more frequently from multiple sources, including the SEC, federal prosecutors, state attorney generals, regulators, and listing agencies. In 2003, this prosecutorial action caused tension among those with the power of enforcement and also increased the complexity of defending registrants and individuals accused of wrongdoing.

The increasing pace of investigations and heightened scrutiny of corporations highlighted occasional differences in approaches by the SEC, Justice Department and other governmental agencies.

For instance, a 2003 SEC press release criticized the Oklahoma Attorney General for not cooperating with federal officials related to his prosecution of the WorldCom matter, and thereby possibly jeopardizing the federal criminal cases being prosecuted against WorldCom.

Complications arising out of the multiple proceedings make the selection and expertise of defense counsel all the more important.

Help Wanted; SEC Looks to Hire

The SEC's 2003 budget of $716 million is set to increase again in fiscal year 2004 to $811.5 million. The 2004 budget is almost twice the size of the SEC's $423 million budget in 2001. The government mandate is clear: hire more professionals both to preempt future financial reporting calamities and to enforce the law against wrongdoers.

Along with this substantial increase in funding, the SEC has been hiring a

"No legislature, no regulatory agency, and no oversight body can stamp out greed."

Kayla Gillan,

PCAOB Board Member

significant number of new staff. In 2004, the SEC expects to complete the hiring of 842 additional positions it received approval for in 2003.

This hiring process was aided by the amendment of the civil service hiring rules for accountants. The Commission can now hire staff accountants under the same rules it applies to the hiring of attorneys, reducing a hiring process that once took months down to weeks. However, complicating this process is a current shortage of accountants. The Big Four accounting firms and the PCAOB both are also currently trying to recruit for their accounting staff.

Table 1

Tally of Enforcements by Level of Individual

Position of Individual	Number of Individuals Charged	Number of Individuals Charged with Fraud
Chairmen	75	63
CEOs	111	99
Presidents	111	96
CFOs	105	79
COOs	21	19
CAOs	16	14
VP's of Finance	27	19
General Counsel	11	8
Controllers	47	28

Table 2

Corporate Fraud Task Force Accomplishments

Criminal Prosecution Statistics, July 9, 2002 - May 31, 2003

250	Corporate Fraud Convictions
320	Current Investigations
500	Individual Subjects under review
169	Currently filed cases
354	Subjects involved in pending cases

Civil/Regulatory Enforcement, Statistics through June 30, 2003

443	SEC Civil Enforcement Actions filed
11	Companies suspended from trading
30	Companies' assets frozen
124	Actions sought to bar Executives from practice within public companies

Sarbanes-Oxley Penalties Invoked

In 2003, we had "firsts" and new precedents set arising out of the landmark Sarbanes-Oxley legislation and its new powers and penalties.

The believed-to-be first criminal action under the section 302 certification rules was Weston Smith of HealthSouth.

While the SEC did utilize the temporary freeze authority granted to it under section 1103 of Sarbanes-Oxley, the provision that appears still open to name a "first" is Section 304. Under Section 304, in the event of a restatement by a registrant as a result of misconduct, the CEO and CFO must reimburse the registrant for any bonus or other incentive-based or equity-based compensation, as well as any profits realized on sales of securities of the registrant in the last twelve months.

On Your Mark, Get Set, Go. Life in the Financial Reporting Function

As if the pressures of more disclosure and transparency were not enough, starting December 15, 2004, annual financial statements are due to the Commission 60 days after fiscal year end. The filing deadline had previously been shortened to 75 days from 90 days as of December 15, 2003. Quarterly filing time periods have also been shortened in total by 10 days to 35 days after period end (as of December 15, 2004).

This change may have little impact on larger, well organized and well staffed registrants. However, for some registrants this shortened period could be problematic, especially when considering the existence of thinly staffed accounting departments and the dependence on key personnel. Proper assessments and planning by registrants is key to avoiding the reputational risks of seeking extensions for quarterly and annual filings. Combined with the enhanced penalties of Sarbanes-Oxley, the motto seems to be get it done quicker, but make sure it's right.

Score Cards and Report Cards

For those who follow the actions of the SEC, two notable reports came out in 2003.

In January, as mandated by Sarbanes-Oxley Section 704, the Commission released its enforcement activity report for the five years ending July 30, 2002. Included among the many notable items in the report was a tally of enforcement actions by level of individual (see Table 1).

In July the Corporate Fraud Task Force, which includes professionals from the Commission as well as other governmental investigative and prosecutorial offices, issued its first anniversary report noting the accomplishments during its twelve months in existence (see Table 2).

Over time, trends in these numbers will highlight the targets of prosecutorial and regulatory attention and will provide

"It could drive a wedge between lawyers and clients. The system won't work, you will have corporations that won't feel they can consult lawyers."

M. Peter Moser, Chairman of American Bar Association (ABA) Task Force

"This bill will not only act as a deterrent, but even more importantly will help restore some faith in the process for investors who have plenty of education in the school of hard knocks."

Mike Oxley, Congressman, Chairman of Financial Services Committee

insight regarding the on-going results of their enforcement activities.

Client Advocate, But to a Limit

The new rules for attorneys that practice before the SEC have caught everyone's attention in the legal profession. The rules were adopted by the SEC on January 23, 2003 and became effective August 5, 2003. They require, among other things, that attorneys report evidence of a material violation "up-the-ladder," initially to the chief legal counsel or the chief executive officer. If the attorney feels that an appropriate response has not been provided in a reasonable amount of time, the attorney must report the material violation to either an independent committee of the board of directors or to the full board.

At the time these rules were adopted, the SEC chose to extend the comment period on the "noisy withdrawal" provisions that were originally proposed. Additionally, the Commission proposed an alternative solution whereby the issuer, not the attorney, would be required to publicly disclose the withdrawal of the attorney.

For years, auditors have dealt with Rule 10A of the Securities Exchange Act of 1934 and its requirement for auditors to disclose illegal activities of registrants to the Commission under certain circumstances. However, auditors are independent of their clients and owe a duty to the investing public, while attorneys are advocates for their clients. The sanctity of the attorney-client privilege also is a major difference from the duties and rules governing the auditor.

Congress Proposes New Legislation to Strengthen SEC

In May of 2003, U.S. Congressmen Richard Baker (R-LA) and Michael Oxley (R-OH) introduced a bill to "strengthen the SEC's enforcement powers and increase its ability to return funds to defrauded investors." The Securities Fraud Deterrence and Investor Restitution Act was pending in the subcommittee at year-end. The proposed legislation would:

- Exclude SEC fraud judgments from state law property exemptions, allowing additional assets to be recoverable by the SEC.
- Change civil enforcement provisions and increase maximum fine per violation.
- Allow access to grand jury information when there is shown to be a "substantial need in the public interest."
- Increase the subpoena range related to civil actions brought by the SEC.

Most interesting are the proposed changes related to SEC access to privileged and work-product protected documents. Under the proposed legislation, registrants could voluntarily produce information to the SEC without waiving the privileges associated with produced documents. Should this legislation become law, a significant hurdle to registrant cooperation with the SEC would be removed.

This legislation shows that, in addition to providing the SEC with greater financial resources, Congress intends to continue its support by increasing its regulatory authority.

On the Horizon

Section 404 of Sarbanes-Oxley requires registrants to document and evaluate their internal controls over financial reporting, and it requires both the registrant as well as the auditor to opine on these controls annually. The SEC originally proposed that registrants comply with Section 404 beginning in September 2003. In August of 2003, the SEC deferred the original compliance dates. At the time this report went to print, the current SEC rules will require certain registrants ("accelerated filers") to comply with Section 404 for fiscal years ending on or after June 15, 2004. All remaining registrants will be required to comply beginning with fiscal years ending on or after April 15, 2005. Prior to the implementation date, additional guidance will likely be provided by the regulatory authorities.

PCAOB

The Public Company Accounting Oversight Board ("PCAOB") or ("the Board") was created by Sarbanes-Oxley to oversee the auditors of public companies. In 2003, the PCAOB began its oversight work and adopted its first auditing standard in December.

It's an .ORG not a .GOV

While ".org" versus ".gov" might be a subtle difference in terms of internet addresses, the fact that the accounting oversight board is not a government agency but rather a not-for-profit entity creates significant distinctions.

Possibly most significant is the battle for talent; the board is paying private sector competitive wages. This issue is probably most significant to the SEC. While the PCAOB and SEC compete for similar accounting candidates, the SEC is constrained by government pay levels from paying salaries similar to those offered by the PCAOB.

"We're looking for really quality people…To some extent we're also competing with the PCAOB and they can pay a lot more."

Donald Nicolaisen,

SEC Chief Accountant

"At the end of a Board (PCAOB) investigation, we will take any necessary action against the accountants. We will turn our findings regarding the company's financial reporting over to the SEC."

Daniel Goezler,

PCAOB Board Member

It also means the Board's direct powers related to the accounting firms it monitors are derived from contract law arising out of the firms' registration with the Board. The Board lacks subpoena and other prosecutorial powers without teaming with, or referring back to, a ".gov."

The First Auditing Standard Leaves No Doubt as to Who is in Charge

In December, the accounting oversight board issued its first auditing standard marking a landmark change in the language for future audit reports. Under the new standard, no longer will the report state "…conducted in accordance with generally accepted auditing standards." Instead the report will read "…conducted in accordance with standards established by the Public Company Accounting Oversight Board." The standard must be approved by the SEC before becoming effective.

Prior to the establishment of the Board, generally accepted auditing standards were the responsibility of the Auditing Standards Board, a group organized by the American Institute of Certified Public Accountants (AICPA). Now responsible for auditing standards, the Board couldn't have picked a better place to let the financial reporting world recognize its authority than by stating its position directly in the auditor's report.

Before publishers recall auditing textbooks, there will likely be more changes to auditing standards forthcoming from the accounting oversight board.

Another GAAP Watchdog

The peer review process that audit firms previously conducted for each other to monitor quality and compliance with auditing standards is now a primary role of the Board.

Many critics of the audit profession didn't believe the peer review process adequately identified weaknesses and that, as an "intra-profession" review process, it lacked true independence. The accounting oversight board certainly changes that perception.

Additionally, in its review of audit workpapers, the Board will have an informative view into accounting policies and judgments made by registrants in the financial reporting process. It appears the Board will use this information to make referrals to the SEC with regard to potential financial reporting misstatements at registrants.

The communication process between the auditors and the registrants also raises many questions, including:

- Will auditors be allowed to inform a client when the client's audit has been selected for review by the PCAOB team?
- What if the PCAOB concludes an audit was not performed in accordance with generally accepted auditing standards? If so, when in the process is the registrant informed there may be a problem with the audit?

As of year-end, no official press release of the PCAOB has addressed these questions.

> **"In order to realize the benefits of truly global financial reporting, we need convergence in…accounting, auditing, and disclosures."**
>
> Scott Taub,
>
> SEC Deputy Chief Accountant

> **"If the US Congress or political authorities in other countries seek to override the decisions of the competent professional standard setters… accounting standards will inevitably lose consistency, coherence and credibility,"**
>
> Paul A. Volcker, former Federal Reserve Board chairman and current chairman of the foundation that oversees the IASB

FASB and IASB

"Convergence" Movement Towards Uniformity in Global Standards

Right now, Generally Accepted Accounting Principals (GAAP) varies on a country-by-country basis and can involve different sets of rules. Reasons for these differences are as diverse as some of the cultures in countries around the world. Business practices, structures and preferences vary globally and a natural consequence is that accounting standards may vary accordingly.

In a world where our economy is global and the free flow and formation of capital across borders is good for all, uniformity in accounting standards should be a high priority. In furtherance of the goal, the FASB and the International Accounting Standards Committee ("IASB") have begun to work formally together towards "convergence" of accounting rule making.

The IASB was formed several years ago as a result of a restructuring of the International Accounting Standards Committee. Its purpose is to work toward the development of a "single set of high-quality global standards," including consideration of US based accounting standards.

The IASB's pronouncements, known as International Financial Reporting Standards, will be mandatory in the European Union in 2005. The SEC monitors the projects and proposals of the IASB in a similar fashion to how it tracks FASB activities.

In 2002, the IASB and FASB began to work more closely together, sharing agendas and teaming on key issues. In December 2003, the FASB issued the first exposure drafts that resulted from these efforts. In a December 2003 news release, the FASB explained the proposed new rules as follows:

- Voluntary changes in accounting policies would be required to be applied by retrospective application rather than by cumulative effect adjustment, as currently required;
- Three changes to the calculation of earnings per share;
- Asset exchanges that would require a gain or loss to be recognized on the exchange of similar productive assets based on the fair value of the exchange unless the exchange lacks commercial substance; and
- Unusual ("abnormal") amounts of idle capacity and spoilage costs would be excluded from the cost of inventory and expensed as incurred.

Congratulations to the SFAS Class of 2003

The FASB issued two new Statements of Financial Accounting Standards this year.

Statement No.150 - Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity

Statement No. 149 - Amendment of Statement 133 on Derivative Instruments and Hedging Activities

View at www.fasb.org/st/summary/stsum150.shtml and www.fasb.org/st/summary/stsum149.shtml

Who Really Writes the Rules?

The influence of user groups is substantial on the establishment of accounting rules in America today. In 2003 we continue to see Congress involve itself in the rule making process especially in some historically controversial areas. Two pieces of legislation, the Broad-Based Stock Options Plan Transparency Act of 2003 and the Stock Option Accounting Reform Act of 2003, have attracted considerable bipartisan support in Congress. The Broad-Based Stock Options Plan Transparency Act of 2003, introduced in March, demands a study by the Securities and Exchange Commission to assess the potential impact of broad-based stock-option plans on the economy. Additionally, the legislation would impose a moratorium on new FASB rules related to stock options. The proposed legislation is currently pending in subcommittee in the U.S. House of Representatives.

"If there's a shortcoming to oversight, it's that the PCAOB can't let another [big firm] fail. If firms get to a situation where they know this, it could be a problem."

Charles Mulford,

Professor of Accounting at the

Georgia Institute of Technology

"I worry, however, that they (colleges and universities) are not attracting enough of the best and brightest students... We must all work together to find ways to rejuvenate accounting as a chosen field of study."

Kayla Gillan,

PCAOB Board Member

Competition: Do You Really Have a Choice?

The ranks of the major accounting firms have shrunk to the "Final Four," plus a couple smaller global firms that primarily serve mid-sized companies. In addition, when factoring in further limitations caused by industry concentrations at specific firms, as well as the "costs" to change auditors (including the risk of disagreement over prior accounting judgments) registrants seldom change auditors.

To analyze the situation, Sarbanes-Oxley mandated a study by the U.S. General Accounting Office (GAO) on public accounting firm consolidation and competition, which was issued in July 2003.

The GAO report states "we found no empirical evidence that competition in the audit services market has been impaired to date." It also reports that the "most observable impact of consolidation appears to be on the limited number of auditor alternatives for large national and multinational companies that require firms with extensive staff-resources, industry-specific and technical expertise, geographic coverage and international reputation."

The July 2003 report was followed up by a supplemental report in September 2003 that presented selective large public company views on accounting firm consolidation. Notable facts contained within the report included:

- 50% of respondents used their current auditor for 10 years or more.
- Almost all respondents used their auditor of record for a variety of services besides audit and attest.
- Company/Auditor Relationships averaged 19 years.
- 88% of respondents said that they would not consider using a non-Big 4 firm for audit or attest services.
- 86% of respondents said that they would prefer a market with more than four big firms.
- 67% of respondents said they would not suggest any actions such as government intervention to increase competition.

Some commentators still feel the financial reporting world would benefit from more choices among the major accounting firms. Unfortunately, the industry has shown little ability to produce a new major participant that the public markets accept or for whom registrants are willing to incur the "costs" that change involves.

Tougher (Or Just New?) CPA License Requirements

To become an attorney, one must graduate law school, pass the bar exam, and apply for admission on a state-by-state basis. Other professions requiring an admittance process or license requirements have similar patterns.

Becoming a CPA, and more importantly the type of license granted to a CPA, will now vary based on state rules and the experience of the accountant under what most people refer to as the "150 hour requirement." This requirement mandates that to be able to take the CPA exam, one must have completed a fifth year of college education or its equivalent.

Therefore, CPAs will now have a longer educational term, generally in the form of earning a masters degree. In addition, a form of restricted CPA licenses will be awarded to individuals who have no audit experience Their license will not allow them to certify financial statements.

These new rules are established state-by-state and vary significantly, including the dates when they take effect. Many states are now operating under the "150 hour requirement" rule.

"The goal is to strike the appropriate balance between loss of continuity and the need to have a 'fresh set of eyes' involved in the audit."

Jackson Day,

Former Acting SEC Chief Accountant

"A corporation's true economic financial condition cannot be seen when assets are reported at their historical cost amounts. The only objective way that the true economic financial condition of a corporation can be portrayed is to mark to market all of the corporation's assets and liabilities"

Walter Schuetze,

Former SEC Chief Accountant

"Valuation expertise should become part of the working knowledge of auditors."

Douglas Carmichael,

PCAOB Chief Auditor

While these new requirements were motivated by many good reasons, they come at a time when the demand for accountants may be at its greatest level as a result of the previously discussed needs of the Big Four, the SEC and the PCAOB.

SEC Issues New Independence Rules; The People Side

In January 2003 the Commission issued new independence rules for the public accounting industry. Included in these new rules was a requirement that firms rotate the lead audit partner every five years beginning with fiscal years ended after the May 6, 2003 effective date. The prior rules require rotation every seven years. Accordingly, all lead audit partners in their fifth through seventh year of service on public registrants will have to rotate off the client during 2004. As a result, there could be triple the number of normal audit partner rotations in the upcoming year.

The premise underlying changing the audit partner is to bring a new "independent" person to be responsible for conducting the audit. Shortening the rotation period accelerates the frequency for enhancing "independence." This "fresh set of eyes," coupled with the increased regulatory oversight of the accounting profession, could result in increased questioning of historical accounting practices of public companies.

CPA: Certified Public Accountant or "Appraiser"

Once again in 2003, the usefulness of our system of historical cost accounting and the reliance on judgments and estimates in financial reporting was publicly debated.

In an October speech, Walter Schuetze, former SEC Chief Accountant, challenged the effectiveness of auditing management's judgments and estimates noting that "we have judgments by the auditor piled on top of judgments by management." Mr. Schuetze discussed an alternative approach whereby financial statements would be prepared based on the fair market values of assets and liabilities. There would be numerous "expert" opinions on the financial statements – from the appraiser for all the market value assertions, and one from the auditor on balances for which it has taken responsibility.

In a December speech, Doug Carmichael, chief auditor at the PCAOB, discussed the need for valuation experts to assist in the delivery of the audit function, and stressed that auditors need to understand valuation theory and practices.

Many current accounting standards involve fair value accounting such as the recently adopted standards for business combinations and goodwill impairment. In addition, a change in GAAP requiring the expensing of stock options would involve a valuation exercise. With this increasing reliance on fair value measurements, the issue will become where will the auditors responsibilities for the determination start and stop.

An Added Consequence of Class Actions; Auditor Requested Investigations

Several audit firms created or enhanced their forensic accounting and investigative specialties in 2003. These changes were made not just to generate revenue for the firm, but to play a major role in planning and executing audit procedures for their clients. As important, these forensic accountants are assisting their respective firms' response in assessing shareholder class action allegations made against the management of their audit clients.

Management integrity is an essential component to the audit process. As such, formal allegations impugning this trait must be taken seriously, even though many may be unfounded.

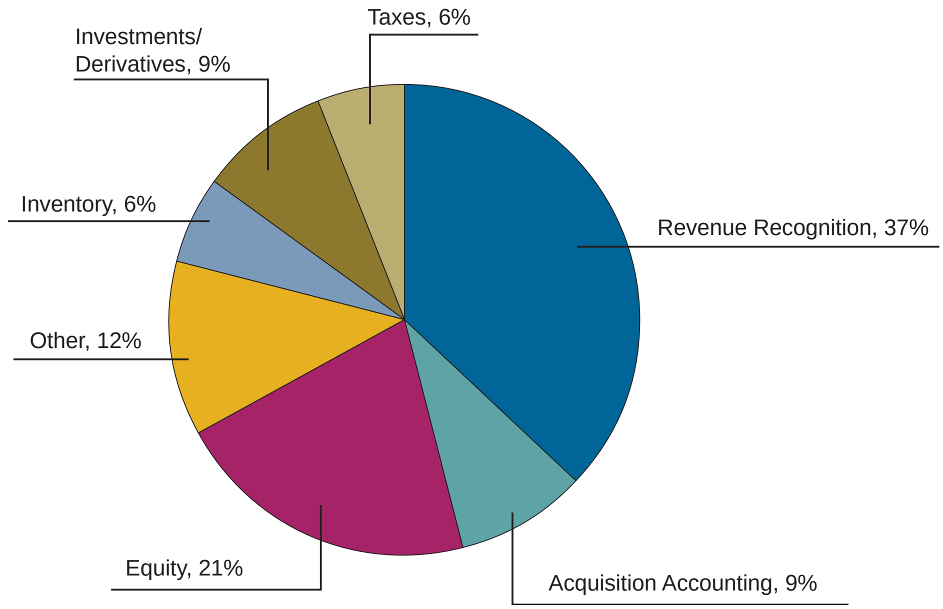
While the observance of special investigations and inquiries arising out of lawsuit allegations may be a growing trend, it is also likely a natural consequence of the combination of (1) PLSRA of 1995, which requires shareholder complaints to "state with particularity" and provide more detailed allegations, and (2) together with the recently issued statement on Auditing Standard No. 99, Consideration of Fraud in a Financial Statement Audit, which requires specific considerations in the planning of the audit, to detect fraud in financial statements.

Industry Analysis

Consistent with prior years, we have tracked restatement issues by industry. Over the past five years, the following four industries have experienced the greatest number of restatements: Software, Manufacturing, Finance, Insurance and Real Estate, and Transportation, Communication, Electric, Gas and Sanitary Service. The following charts illustrate the breakdown of accounting issues underlying restatements in 2003, as well as the number of restatements in each industry over the last five years.

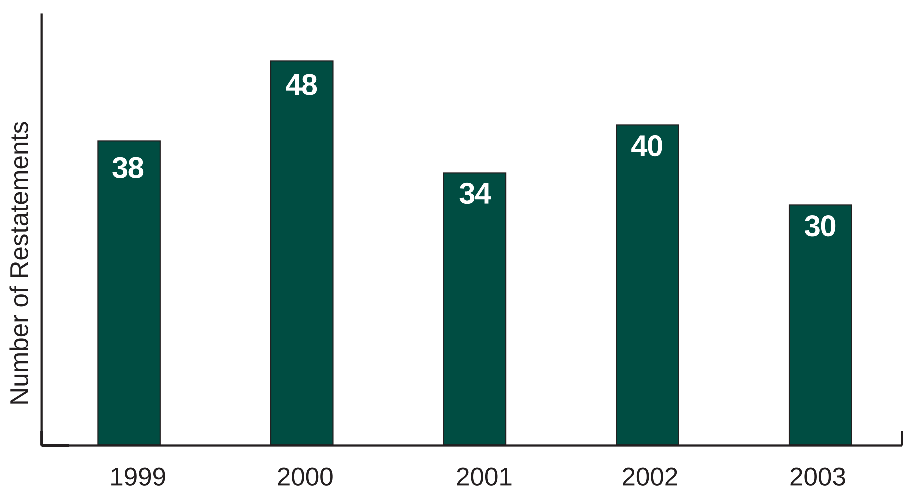
Software Industry

Restatements by Major Category (2003)



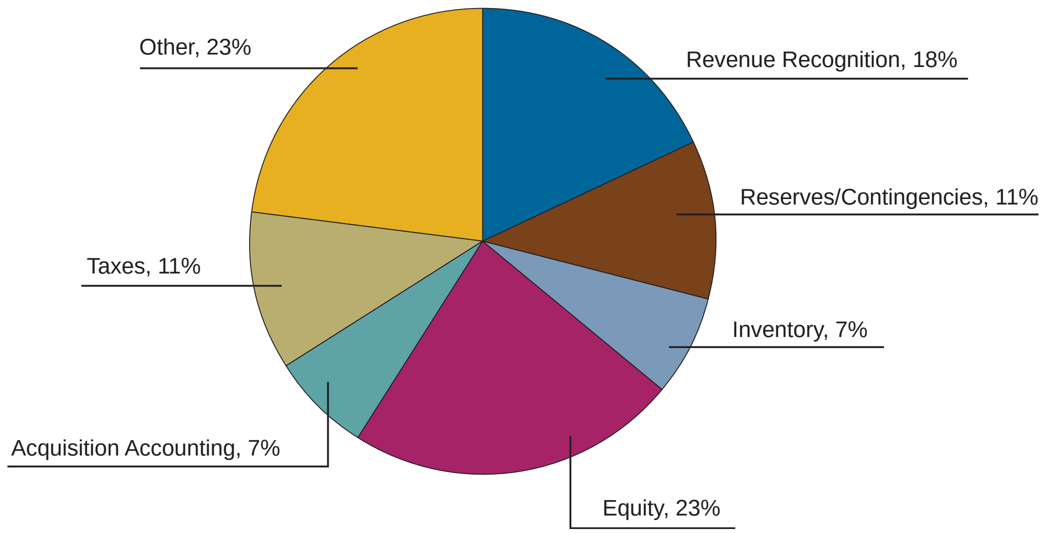
Software Industry

Restatements by Year Filed



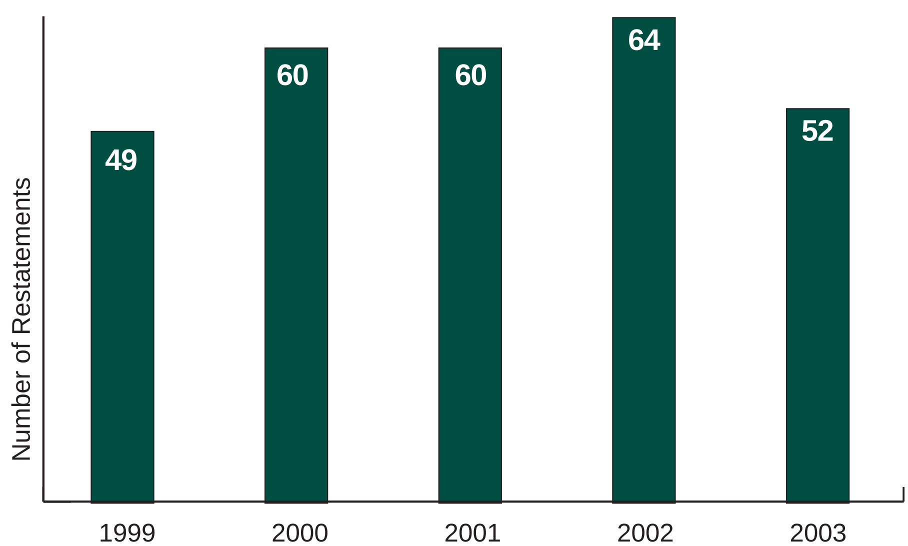
Manufacturing Industry

Restatements by Major Accounting Issue (2003)



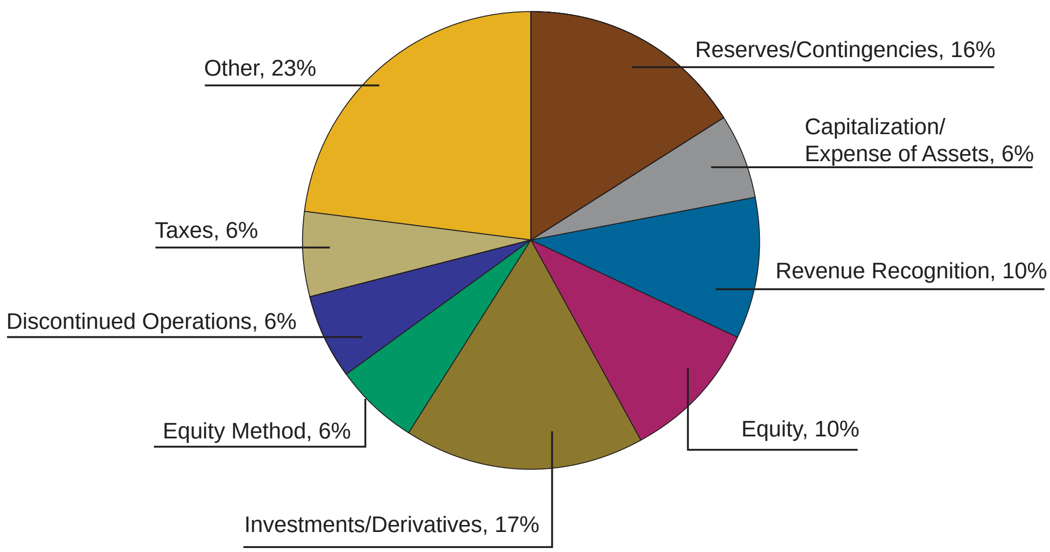
Manufacturing Industry

Restatements by Year Filed



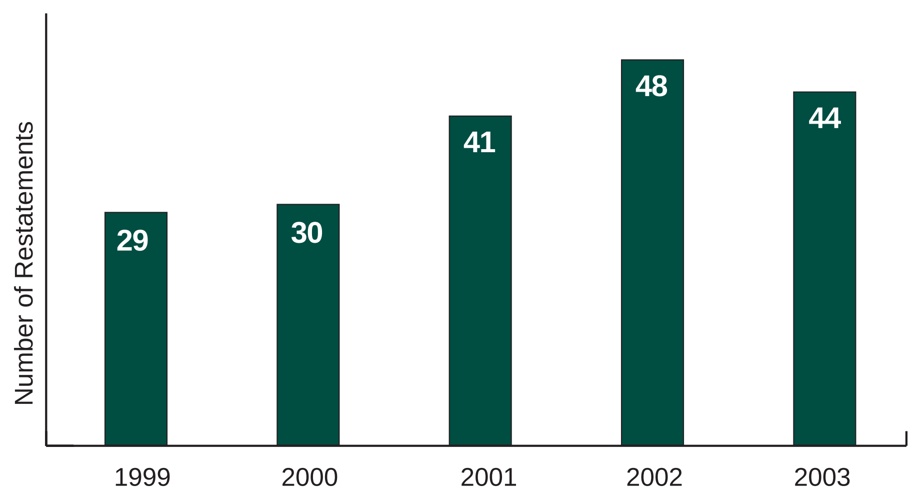
Finance, Insurance, and Real Estate Industry

Restatements by Major Accounting Issue (2003)



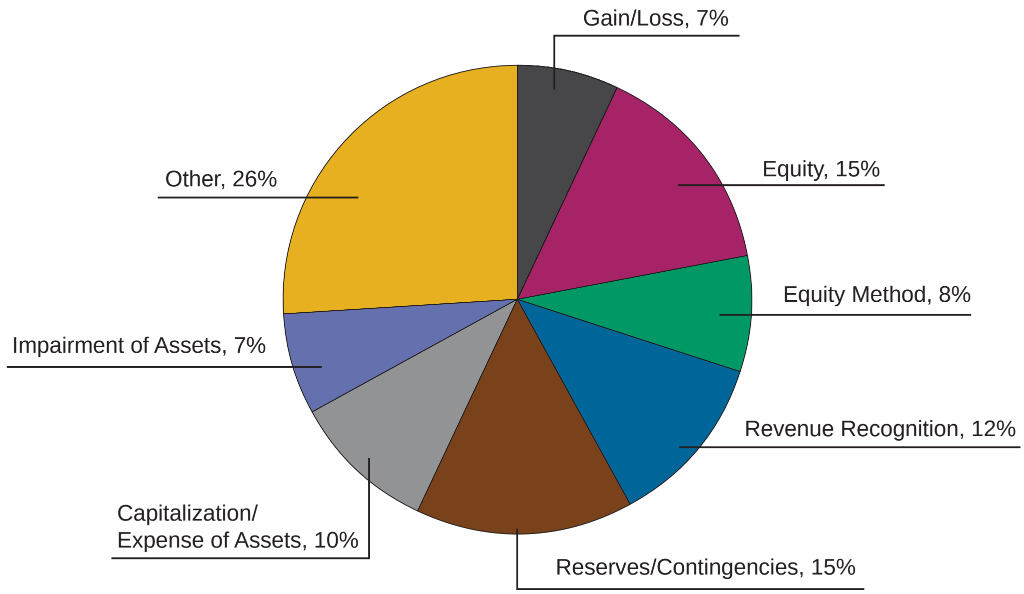
Finance, Insurance, and Real Estate Industry

Restatements by Year Filed



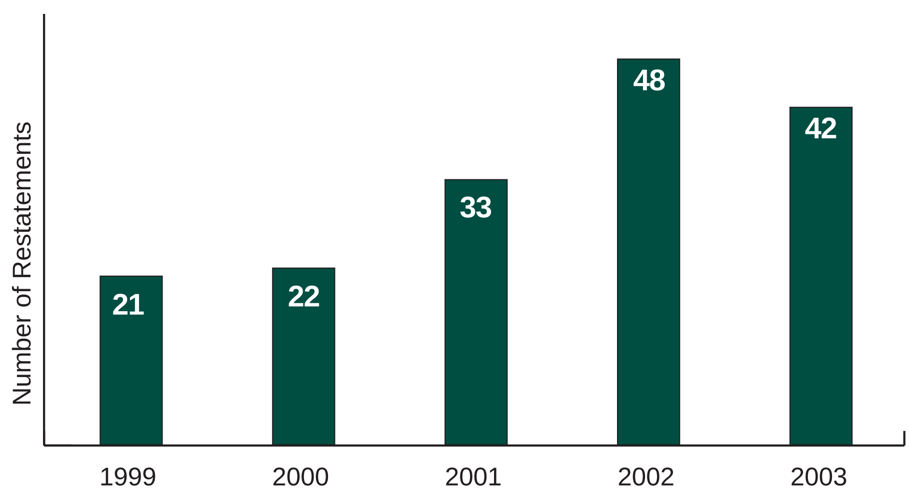
Transportation, Communications, Electric, Gas, and Sanitary Services Industry

Restatements by Major Accounting Issue (2003)



Transportation, Communications, Electric, Gas, and Sanitary Services Industry

Restatements by Year Filed



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