GLOSSARY OF TERMS

As of 2/19/02

The Enron bankruptcy has raised numerous questions about the role of CPAs within the U.S. financial system and about the complex structure designed to regulate publicly held companies and protect the investing public. The following glossary is intended to clarify the statutory obligations of CPAs and define some of the regulatory bodies and financial terms.

AICPA - American Institute of Certified Public Accountants

With more than 330,000 members, the AICPA is the national professional organization for all Certified Public Accountants (CPAs). Its mission is to provide members with the resources, information, and leadership that enable them to provide valuable services in the highest professional manner to benefit the public as well as employers and clients. In fulfilling its mission, the AICPA works with state CPA organizations and gives priority to those areas where public reliance on CPA skills is most significant.

The AICPA is responsible for establishing and enforcing a code of professional conduct and auditing standards in the United States. It is also responsible for establishing and administering quality monitoring (or peer review) programs for CPA firms that perform auditing and accounting services.

Accountant

Although all CPAs have a background in accounting, not all accountants are CPAs. CPAs are licensed to practice accountancy under state law. Only licensed accountants can perform attest services such as an audit of financial statements. The SEC also requires that the signatory of the independent auditors report in an SEC filing be "dually registered" with the appropriate state licensing authority.

Audit

Webster's Seventh New Collegiate Dictionary defines an "audit" as "a methodical examination and review" or, more specifically, "the final report of an examination of books of account by auditors."

The Securities Acts of 1933 and 1934 require the financial statements of all publicly-held companies in the United States to be audited every year by an independent auditor. The SEC subsequently mandated that the annual report of every publicly held corporation contain a *Report of Independent Public Accountants*. The standard audit report states that the goal of the audit is "to obtain reasonable assurance that the financial statements are free of material

misstatement" and that the audit was performed "in accordance with generally accepted auditing standards."

The federal government subsequently expanded mandatory audit requirements to most pension plans, local and state governments, and certain not-for-profit organizations. Audits by CPAs also have become part of many real estate and other commercial agreements, as well as many bank loan requirements.

Audit Committee
Audit committees of boards of directors have become a well-recognized and important element of corporate governance. Ideally, these committees should consist of individuals who are independent of the management of the entity and have a strong degree of financial literacy. Audit committees typically recommend the CPA or firm to be hired as independent auditors and have oversight responsibilities for both the internal audit function and the independent audit. The SEC requires publicly-held companies to include reports by their audit committee in proxy statements. Auditing standards require certain communications between the audit firm and the audit committee.

Auditing Standards Board
The 15-member Auditing Standards Board (ASB), a senior technical committee of the AICPA, issues auditing standards and procedures that must be observed by all CPAs when conducting financial statement audits.

CPA - Certified Public Accountant
A credential conferred by a state or similar governmental jurisdiction that authorizes the holder to practice as a Certified Public Accountant in that jurisdiction. In order to become a CPA, all states require that an individual meet some combination of educational, experience, and ethical requirements and pass the Uniform CPA Examination.

Contingencies
The notes to financial statements describe certain uncertainties as to possible gain or loss, called "contingencies," that will ultimately be resolved when one or more future events occur or fail to occur. These might include, for example, uncertainties as to the outcome of pending or threatened litigation, or guarantees of the indebtedness of others that could have an effect on the financial position or performance of the organization.

FASB – Financial Accounting Standards Board
A private sector body that sets accounting standards (referred to as generally accepted accounting principles (GAAP), the ground rules for the preparation of financial statement for non-governmental entities in the United States. The SEC requires all publicly-held companies to follow the rules set out in FASB pronouncements. Issues deliberated by the FASB include everything from broad concepts such as when revenue should be recognized in financial statements, to

more specific rules such as what information should be reported about a company's different businesses and how pension liabilities should be measured.

Financial Statements
Financial statements present information about an entity's economic resources and obligations at a point in time, the results of its activities during a particular period, and its sources and uses of cash during that period. They focus on information that is useful in making investment and lending decisions. Most financial statements are prepared using a set of common ground rules, which have been developed over a period of many years, and are called generally accepted accounting principles (GAAP).

GAO - General Accounting Office
The GAO is the investigative arm of Congress. It exists to support Congress in meeting its constitutional responsibilities and to help improve the performance and accountability of the federal government. Among its activities are examining the use of public funds, evaluating federal programs and activities, and providing analyses, options, recommendations, and other assistance to help Congress make effective oversight, policy, and funding decisions.

Generally Accepted Accounting Principles (GAAP)
GAAP encompasses the conventions, rules, and procedures necessary to define accepted practice in the preparation of financial statements in the U.S. The SEC has the statutory authority to set accounting standards for publicly held companies but historically has relied, without abdicating its responsibilities, on private sector bodies to set those standards. The Financial Accounting Standards Board (FASB) is currently the private-sector body with the primary authority to establish GAAP for all companies.

Generally Accepted Auditing Standards (GAAS)
GAAS are the standards governing the conduct of independent audits by CPAs, as determined by the Auditing Standards Board (ASB) of the AICPA.

MD&A Section in Annual Reports
The Management Discussion and Analysis (MD&A) section of a company's quarterly or annual report is required by the SEC for all public companies. MD & A disclosures should include in plain English, management's identification and evaluation of all information, including the potential effects of known trends, commitments, events and uncertainties, that is important to providing investors and others with an accurate understanding of the company's current and prospective financial position and operating results. The three required elements in MD&A are: results of operations, liquidity, and capital resources. MD&A also is required to include a discussion of instances where optional accounting treatments were available and the reason for the treatment chosen.

Peer Review

The AICPA administers two peer review programs. The peer review program for firms that audit SEC registrants is administered by the AICPA's SEC Practice Section (SECPS) and overseen by the Public Oversight Board (POB) and the Securities and Exchange Commission (SEC). The peer review program for firms that perform auditing and accounting services for non-SEC registrants is administered by state CPA organizations and overseen by the AICPA's Peer Review Board.

The purpose of peer review for firms that audit SEC registrants is to provide assurance to the public that a firm that performs auditing and accounting services has an effective quality control system. That system must provide reasonable assurance that its auditors and accountants are complying with professional standards, for example, general accepted accounting principles (GAAP) and general accepted auditing standards (GAAS). Peer reviews are aimed at evaluating quality control by testing compliance of a sample of the firm's auditing and accounting engagements. A firm has a peer review every three years by another firm of comparable size.

The POB's oversight of peer review includes field reviews of all firms with 30 or more SEC audit clients. For those firms with fewer than 30 SEC clients, the POB's staff reviews about one of every five peer reviews. SEC staff members randomly inspect a sample of peer review files.

The results of the most recent peer review for firms that audit SEC registrants are publicly available. Each public file also includes the firm's peer review report and, if applicable, a comment letter identifying matters for improvement, the firms' response to such a letter, and a description of any follow-up action deemed necessary by the SECPS.

Public Oversight Board (POB)

The POB is an independent body, which oversees the peer review, quality control inquiry, and other activities of the SECPS and the standard setting efforts of the Auditing Standards Board. Although funded by SECPS member firm dues, the POB elects its own board members, hires its own staff, and sets its own budget without challenge from the SECPS. The POB issues an annual report that makes public all of the POB's important actions from the previous year.

(Note: As a result of recent statements by the Chairman of the SEC concerning proposed changes in the accounting profession's system of self-regulation, the members of the Public Oversight Board have announced their intention to terminate the Board's existence no later than March 31, 2002. Further details as they occur will be communicated to AICPA members on the AICPA Web site at www.aicpa.org*. Click on the flashing green banner.*

SEC - United States Securities and Exchange Commission
The SEC was established by the Securities Act of 1933 and the Securities Exchange Act of 1934. These laws were passed by Congress and signed by President Roosevelt in response to the vast sums lost by investors in the stock market crash of 1929 and the subsequent financial depression.

The expressed purpose of the SEC is to protect investors of publicly held companies and to maintain the integrity of the securities markets. According to the SEC's Web site, its main purpose can be summed up in two common-sense notions:

- Companies publicly offering securities for investment dollars must tell the public the truth about their businesses, the securities they are selling, and the risks involved in investing.

- People who sell and trade securities -- brokers, dealers and exchanges -- must treat investors fairly and honestly, putting investors' interests first.

SECPS - SEC Practice Section of the AICPA
SECPS is one of two firm membership sections of the AICPA. All AICPA members who audit publicly-held companies must work for a firm that belongs to the SECPS. The purpose of the SECPS is to improve the quality of practice of firms. The SECPS has about 1,300 member firms, of which about 800 audit SEC registrants.

Special Purpose Entities (SPEs)
SPE is used to refer to an entity such as a corporation or partnership created to conduct a specific transaction or business activity. The vast majority of SPEs are used for legitimate purposes. For example, mortgage and credit companies use them to sell loans and other obligations to private investors, multinational corporations use them in tax planning strategies, and consumer product companies use them to allow third parties (the SPEs) to act as their consumer finance company.

All of the assets and liabilities of an SPE (except for certain qualified entities typically used for the securitization of assets such as loans), that are legally separate from the reporting organization:
- must be included among the assets and liabilities of the reporting entity***, if***
- the reporting entity has a controlling financial interest in that legally separate entity.

This is referred to as "consolidation." In addition, the beneficiary of the transaction or business activity entered into by an SPE may be required to consolidate the SPE:
- even in the absence of a controlling financial interest in the SPE (indeed, even if the reporting entity has no ownership interest in the SPE) ***if***,

- certain other conditions are met.

The “3% rule” that has been referred to in the press is an element of a publicly-stated SEC staff view concerning when one of those other conditions would be met.