

On the Move



Keeping Pace with Ernst & Young and its Alumni

Winter 2004



Executive Overview

The PCAOB: What it Means to Ernst & Young

The Public Company Accounting Oversight Board (PCAOB) – created as part of the Sarbanes-Oxley Act to oversee auditors of public companies – is up-and-running. This tax-exempt entity reports to the Securities and Exchange Commission (SEC), replacing the existing self-regulatory Public Oversight Board.

“One key observation about the PCAOB and our response is that the board expects professionals – and firms – to know the rules. It is critical that we support our professionals to help them meet this expectation.”

So what exactly is the PCAOB’s charge, and what does it mean to Ernst & Young and our clients? To answer this question I’ll provide some background on the entity, followed by my observations based on a recent presentation by the board chairman, a recent inspection at one of our offices, and various articles I have read on the topic.

The PCAOB is charged with setting auditing standards, registering public accounting auditing firms, inspecting the firms and enforcing compliance. The board is comprised of the chairman, William McDonough, and four members: Kayla

Gillan; Daniel Goelzer; Bill Gradison, Jr.; and Charles Niemeier. The entity will have offices in Washington D.C., New York City, Atlanta, Dallas and San Francisco.

In late 2003, the PCAOB adopted existing auditing standards and proposed rules related to internal control attestation (Section 404) and for investigations and hearings. However, the board has already begun evaluating some general auditing standards. In the next six months, it will look at existing fraud standards. In the next year, the board may challenge other existing standards and make any changes it deems fit.

The board has also begun to inspect the Big 4 firms and has registered over 600 smaller firms. It will commence full inspections of the Big 4 firms by Spring, and will then start designing inspections of the next level of firms.

One key observation about the PCAOB and our response is that the board expects professionals – and firms – to know the rules. We need adequate processes in place to ensure there is a high level of training and practice support for our audit professionals. It is critical that we support our professionals to help them meet this expectation.

To this end, we are focusing on auditing and accounting skills, including increasing training and increasing the importance of technical competence in professionals at all levels. We have instituted an ethics hotline and a code of conduct, including annual

certifications aimed at increasing the flow of information.

As McDonough said during a recent talk at Stanford University, the PCAOB expects each professional to follow the rules “both in the letter and in the spirit.” The good news, in my own terms, is the PCAOB will support those professionals who discharge their responsibilities in a knowledgeable, thoughtful manner. The board will be tough on enforcement, but if we follow the rules it will support the results of our work.

One hot topic is the auditor’s responsibility to detect fraud. During his speech, McDonough commented, “A really good audit should detect fraud, but will it always

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State and Local Tax Update

By Beth Adair and Linda O'Donohue

In the face of looming budget deficits during the 2002 and current legislative sessions, many state and local legislators have suggested that large corporations are not paying their "fair share" of state and local taxes.

Several states have responded with legislated business tax increases. Such measures were intended to help bridge the \$20 to \$30 billion shortfall projected by most states for FY2002, although many states continue to postpone tough budget decisions. FY2003 shortfall estimates are in excess of \$85 billion and represent approximately 15 percent of previously budgeted state tax revenue.

Legislated business tax increases have been varied in nature and include both direct corporate income tax increases and indirect tax increases that affect businesses' non-income tax liabilities. Direct tax changes include "loophole closing" provisions, which often have unintended tax consequences for certain taxpayers' regular business transactions. The data also show increases in indirect taxes such as business property taxes, sales and excise taxes on business inputs, and payroll taxes, which affect both corporate and non-corporate taxpayers.

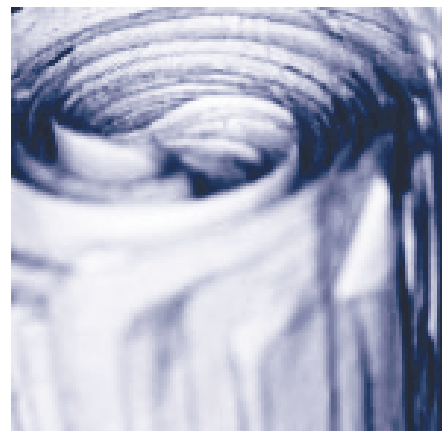
As corporate profitability rebounds, state legislatures will continue to look to business for additional sources of revenue. We can expect to see more corporate income tax base expansion (e.g., NOL and deduction disallowances and limitations on tax credits), alternative tax bases (e.g., New Jersey's gross receipts/profits alternative minimum assessment), additional sales and excise taxes on business inputs (e.g., expanded taxation of sales of business services), and increased business property

taxes. These business tax reforms in combination with increased business profitability will result in a level of total business tax burden not seen for years.

Legislated business tax increases have been varied in nature and include both direct corporate income tax increases and indirect tax increases that affect businesses' non-income tax liabilities.

In 2002, businesses shouldered the burden of increases in state and local taxes, whether due to tax policy or economic changes.

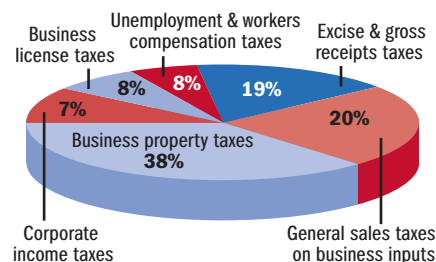
- Business property taxes increased 4 percent during the past year and show signs of stronger future growth. Due to the unusual combination of a relatively strong real estate market in a slow economy, and reductions in state aid as states struggle to balance their budgets, the local property tax may approach double-digit percentage increases in 2003. This will further increase the level of the largest of the state and local business taxes during the coming year.
- Corporate income taxes increased in a period of moderate economic recovery and NOL carry-forwards. Increased liabilities resulting from New Jersey's CBT legislation account for over \$400 million of this increase while Oregon collected an additional \$230 million after eliminating a rebate paid to corporate taxpayers in 2001.



- Unemployment taxes increased 9.9 percent in 2002, representing more than \$2.7 billion in additional business payments to government.

Clearly, it is time for business taxpayers to review their state and local tax planning to ensure that the strategies will continue to provide the anticipated tax savings. To the extent that the tax savings are minimized or eliminated, it may be time to review the business operations and consider how to best link tax planning strategies with business operations.

Distribution of State and Local Taxes in FY 2002



In 2002, indirect taxes (e.g., sales and use taxes, property taxes, employment taxes and business licenses) represented 91 percent of the total state and local business taxes paid. These "above the line" costs directly affect earnings from operations and impact cash flow. In the past, indirect taxes have often been considered hidden taxes and overlooked as a cost of doing business. As businesses become more focused on increasing cash flow and minimizing costs, the tax departments have increased scrutiny of the indirect taxes.

If you are interested in more information about Ernst & Young's State and Local Tax Practice, please contact Beth Adair at (503) 414-7933 (elizabeth.adair@ey.com) or Linda O'Donohue at (206) 654-7451 (linda.odonohue@ey.com).

State and local business taxes increased over \$17 billion in calendar year 2002, totaling over \$391 billion. The total taxes paid by business include:

- Property taxes on business property (\$149 billion)
- Sales and excise taxes paid by business on business purchases (\$148 billion)
- Corporate income taxes (\$34 billion)
- Unemployment insurance and workers compensation taxes (\$30 billion)
- Business license and other taxes (\$30 billion)

Meet Lori DePole, COO, Official Payments, Inc.

Lori DePole is chief operating officer for Official Payments, Inc., which provides electronic payment options to government entities. Official Payments, a subsidiary of Tier Technologies, Inc., enables customers to use their credit cards to pay by telephone or through the Internet. Customers are able to pay their personal federal and state income taxes, sales and use taxes, property taxes, utilities, fines for traffic violations and parking citations, and many other forms of government payments.

"I started at EY right out of college in 1988. I received amazing exposure to a broad range of clients and projects.

I was involved in tax consulting, audits, and mergers-and-acquisitions consulting. My time at the firm really developed me as a professional and taught me to be quick on my feet in handling new situations."

Lori's job spans all aspects of running Official Payments – from managing employees to managing relationships with credit card companies and government clients and working with sales and development staff to bring in new government clients. Prior to this new position, Lori was

the chief financial officer and chief administrative officer of the parent company. She said her nine years at Ernst & Young provided her with a broad range of experience that has prepared her to carry out her job responsibilities today.

"I started at EY right out of college in 1988," Lori said. "I received amazing exposure to a broad range of clients and projects. I was involved in tax consulting, audits, and mergers-and-acquisitions consulting. My time at the firm really developed me as a professional and taught me to be quick on my feet in handling new situations."

Lori said her firm experience also enabled her to hone in on analytical skills that she now uses daily. "When I'm reviewing a business report, a contract or financial statements, the skills Ernst & Young helped me develop allow me to better assess the risk and opportunity and do what makes the most sense," she said.

When Lori left the firm, she was a senior manager in the Tax Consulting Group, having moved from the San Francisco office to the Walnut Creek office. She decided she was ready to leave public accounting and was forthcoming about this decision with the firm.

"I let people know I wanted to make a career change and asked if they would help me," Lori recalled. "I have tremendous loyalty to Ernst & Young and wanted to make sure I left on good terms. I didn't

want to just find a job and let them know after the fact. In response, partners talked to me, provided career counseling and helped me to make contacts. Partner Nigel Martin in Walnut Creek facilitated my interview with Tier. I was so impressed and grateful at how he and others were involved in my career growth and were so receptive and responsive."

While Lori has fond memories of many Ernst & Young partners, she is especially grateful to Nigel for his help during her career transition, and Jay Espovich, who is now retired. "Jay was the main reason I made the move from San Francisco to Walnut Creek," she said. "He was a wonderful mentor."

Lori lives in Diablo, Calif. with her husband, Ray DePole, an Ernst & Young partner she met while at the firm. They are both huge Oakland Raiders fans and go to all of the team's home games and some away games. In her spare time, Lori enjoys golf and watercolor painting.

You can reach Lori at ldepole@officialpayments.com.



Lori DePole and her husband, Ray, during a recent vacation in Mexico.

IN THE NEWS

Visit www.alumni.ey.com

Have you visited our new alumni network at www.alumni.ey.com? If not, log on today and register!

We offer you the following special services and benefits via the alumni Web site:

- Directory of all Ernst & Young alumni
- Career Center, including marketplace jobs and opportunities at Ernst & Young
- News page, including updates about Ernst & Young and the accounting profession
- Calendar of Ernst & Young alumni events and activities taking place across the country
- Access to discounted CPE courses for alumni
- An alumni referral incentive program to reward alumni who refer candidates to Ernst & Young



Ernst & Young's Real Estate Advisory Services Offers Benefits Across Industries

For some time, Ernst & Young's Real Estate Advisory Services (REAS) practice has been one of the firm's best-kept secrets. But the group, led by Global Director Mark Smith, is eager to shed this status. Mark wants to spread the word that REAS provides valuable services to companies in every type of industry.

Ernst & Young has the largest real estate advisory practice of any of the Big Four firms, and is the only firm with a global practice. With about 500 professionals, about half of whom are based in countries outside the United States, the practice offers a comprehensive array of real estate-related services, including real estate strategy development, location strategy, finance strategies, construction management oversight, portfolio optimization and property disposition.

The Need for a Real Estate Strategy

A recent survey conducted by the practice showed that 55 percent of companies have no real estate strategy in place, even though real estate is typically the second-largest expense on the income statement, just below labor costs. Even more surprising is the fact that most large corporations don't know how much space they own or lease, let alone what it costs to occupy that space, which includes all the costs associated with ancillary services, utilities and maintenance. This makes real estate a prime target for companies looking to reduce their costs in an uncertain economy.

But in any economy – robust or anemic – “It's crucial for companies to maximize value and reduce the risk associated with such a substantial core asset,” Mark emphasized. REAS does that by showing companies how to realize “hidden” cost savings by reducing the cost of operations, disposing of excess or unwanted real estate, tapping into capital that is locked in owned real estate, and enhancing real estate-related processes.”

Also, as companies prepare to build space in new locations, they usually have large capital budgets to manage wisely. Once construction is under way, they must have effective financial controls in place. “We have found that 99 percent of companies do overrun their budgets on large capital programs,” Mark said, “so program management oversight is critical.”

Typically, real estate is not a core competency for major corporations, Mark noted. “Yet if these companies were to compare themselves to professionally run real estate organizations, such as real estate investment trusts [REITs], they would find that they either own or control more real estate than the largest REITs – in some cases amounting to hundreds of millions of dollars.”

This is an opportune time for companies to benefit from REAS services because the economy is forcing them to look for cost savings in areas they haven't thought of before. For example, a company may have as much as 10 percent to 15 percent of its property standing empty. Or, it may be retaining property in locations that have become undesirable because of transportation problems, an expensive labor pool or other changes.

Looking beyond the recession, companies need to position themselves for the economic recovery so that when the economy does gather strength, they will be able to make the right investments from a real estate perspective. A company may decide, for instance, to consolidate properties not only to reduce costs but also to improve operational efficiency.

A Relatively New Practice

A branch of National Advisory Services, the REAS practice was officially formed in the fall of 1998. While it is not organizationally a part of the Real Estate, Hospitality and Construction (RHC) practice, which focuses on audit and tax services, it coordinates closely with RHC in areas of mutual interest.

REAS targets two types of clients. The first group comprises operational users, including large Fortune 500 corporations, emerging growth companies and government. The second comprises real estate investors, including investment banks, REITs, developers and hospitality enterprises.

Strong Growth Expected

“Within the United States, there are many areas viewed as having the potential for creating centers of excellence,” Mark said. Areas targeted for expansion include Atlanta, home to major financial institutions, as well as biotech and research firms; Chicago, with its strong trade, retail and

manufacturing base; and San Francisco, where high-technology companies are beginning to emerge from a severe downturn. “These companies have major real estate asset needs to tackle, but with all the downsizing they have gone through, they need help with these issues,” he said.

Currently, 20 to 25 REAS professionals are located in each of these major urban centers. Mark said he sees that number doubling or tripling during the next three to five years as the practice carries out its aggressive growth plans. Overall, the number of professionals in the United States is expected to approach 1,000, with at least an equal number in other countries.

Globally, REAS has significant operations in the UK, Germany and France, as well as an emerging presence in the Far East. But there is still tremendous room for expansion in Europe, Mark added, because major corporations there are now outsourcing many of their real estate functions and need a best practice model. One of the latest thought-leadership initiatives of the practice is a global survey of corporate real estate outsourcing.

The practice in Europe will also continue to be locally driven, Mark said. “For example, if a client headquartered in New York wants to open a distribution center in Dublin, we need to be able to tap into local resources to find space for that client.”

In Asia, the opportunities for expansion are more on the investment side because of the abundance of distressed real estate debt and non-performing loan portfolios.

Mark said he believes the goal of strengthening REAS market dominance is well within reach. “Every client of the firm has real estate issues,” he said. “We believe there is a great untapped opportunity for our services. Every company out there needs to maximize the value of its real estate and reduce the risk associated with it.”

If you are interested in more information about Ernst & Young's Real Estate Practice, please contact Dave Sawaya for AABS at (415) 248-2006 (david.sawaya@ey.com), Robyn Dahlin for Tax at (415) 743-4312 (robyn.dahlin@ey.com), or Darin Buchalter for Advisory Services at (415) 248-2008 (darin.buchalter@ey.com).

Celebrating Lou Pugliese, Deceased Partner

On the evening of Nov. 17, Ernst & Young professionals gathered to remember Lou Pugliese and honor his family by celebrating “The Life of a Wonderful Colleague, Teacher and Friend.” Lou was a partner in the San Jose office for 30 years.



Pacific Northwest Area Managing Partner Mike Strachan opened the evening with his personal reflections about how Lou demonstrated greatness through his daily discipline of “doing the right thing.” Retired Partner Paul Faux shared memories of Lou as a mentor and friend over three decades. San Jose Partner Rod Gibbs gave a poignant testimonial of a day in the life with Lou and how he could touch lives through simple, genuine and unique expressions of kindness, friendship, insight, professionalism and humor.

The evening was filled with special touches, including a video that captured the memories of Lou as shared by Ernst & Young professionals. The Pugliese family was presented with the compilation of memories. The firm also presented a plaque to the family that contained memories of “What Lou Valued” and “What He Taught Us.”

The evening culminated in the dedication of the Louis A. Pugliese Training Center. Mike dedicated the center with the words, “How appropriate to remember the life of such a great man and great teacher by dedicating the training center where we continue to learn and grow.”

Members of the Pugliese family were extraordinarily gracious in their appreciation. Athena Pugliese, Lou’s wife, gave a moving tribute to Lou as he was seen through the eyes of his family.

In all, it was an evening of emotion spanning laughter to tears, but with wonderful memories of a full and complete life. Thank you to the many individuals who made the evening such a special tribute.

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find fraud when it’s well organized with an inner core that includes the CEO? Probably not.” This and other comments, such as his statement that internal control testing needs to be cost-effective, indicated a degree of practicality about implementing the Sarbanes-Oxley Act. He essentially said that pricing U.S. corporations of business to be “virtuous” isn’t really an option. My take is that McDonough is practical but tough-minded.

As a side note, another interesting statement from McDonough was regarding the level of compensation for CEOs. He expressed concern that the level of executive compensation still had the capability to undermine public support for a free-market economy. Therefore, there may be further legislation around executive compensation.

In summary, Ernst & Young is taking the right steps to follow professional standards in everything that we do. That is the best way to be “PCAOB ready.”

Mike Strachan

Mike Strachan, Area Managing Partner

KEEPING IN TOUCH

Palm Pilot

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Ernst & Young Announces National Entrepreneur Of The Year Award Winners

Ernst & Young acknowledged the national winners of its Entrepreneur Of The Year® award at a gala on Saturday, Nov. 22, 2003, in Palm Springs, Calif.

John Mackey, chairman, CEO and president of Austin, Texas-based Whole Foods Market, was named the 2003 national Ernst & Young Entrepreneur Of The Year award winner. Of the 31 national finalists, eight were from Northern California and two were honored as national winners.

Charles (Chuck) Geschke and John Warnock of Adobe Systems, Inc. have been named the 2003 Ernst & Young Entrepreneur Of The Year award winners in the Information Technology category. Adobe System's market-leading programs have made the California-based company one of the great success stories of the Information Age.

Sergio Magistri of California-based InVision Technologies has been named 2003 Ernst & Young Entrepreneur Of The Year award winner in the Defense and Security category. InVision Technologies' high-end explosives detection systems are used all over the world for screening passenger-checked baggage.

Magistri, Geschke and Warnock, along with other national Ernst & Young Entrepreneur Of The Year category winners, were selected from 400 regional award recipients by an independent panel of judges.

Northern California's national finalists were John C. Martin, Ph.D., Gilead Sciences, Inc.; Sergio Brin and Larry Page



National EOY Information Technology category winners from Adobe Systems, Inc.

of Google, Inc.; Amnon Landan of Mercury Interactive Corporation; Daniel J. Warmenhoven of Network Appliance; Jen-Hsun Huang of NVIDIA Corporation; and Levy Gerzberg, Ph.D., Zoran Corporation.

Each year Ernst & Young, through its Entrepreneur Of The Year awards program, seeks to recognize and support outstanding business achievements around the world.

Such accomplishments are a reflection of the vision and determination of entrepreneurs to imagine the future and become part of it, see change and embrace it, and set the bar higher. By building strong, innovative and dynamic businesses, these remarkable men and women provide jobs, grow our communities, strengthen our economies and improve the world.

The nomination campaign began in January 2003. 3,400 nominations were received from around the country. From the nominations, almost 400 Entrepreneur Of The Year winners were chosen by independent panels of judges and honored in June in 37 regions across the United States.

Do You Know Someone Who Should Be Nominated?

We're looking for successful men and women who have founded or are growing leading-edge companies. A nominee must be an owner/manager responsible for the recent performance of a private or public company that is at least two years old.

Nominations can be submitted by anyone who is associated with a successful entrepreneur – spouses, employees, bankers, attorneys, public relations personnel, managers or the entrepreneurs themselves.

If you know someone who possesses the skills and determination to make a great idea work, nominate him or her for the coveted Ernst & Young Entrepreneur Of The Year award. A copy of the nomination form and complete information on the Entrepreneur Of The Year awards program is available on our Web site at www.ey.com/us/eoy or by calling Laura Gordon at (408) 947-5638.

The Northern California deadline for nominations is March 26, 2004.

All financial information submitted on the nomination form is considered confidential and will be used only by the sponsors and by the independent panels of regional and national judges.

What's New With You?

Please let us know where you are and what you're doing so we can print this information in a future issue of *On The Move*. In addition, we would like to receive your feedback and suggestions regarding the Northern California Alumni Program.

Name: _____ Company: _____

Title: _____ Address: _____

Phone: (W) _____ (H) _____ E-mail: _____

Home address: _____ Date you left the firm: _____

What would you like to report in the next alumni newsletter? _____

Do you have any comments/suggestions about the alumni program? _____

Return the above information by e-mail, fax or mail to: Julie Eisenhauer, Ernst & Young, 303 Almaden Blvd., San Jose, Calif. 95110
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