

REPORT OF THE 2001 AUDIT COMMITTEE TO THE COUNCIL
OF THE AMERICAN PHYSICAL SOCIETY

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A. INTRODUCTION AND OVERVIEW

The Audit Committee met on October 25, 2001 with Tom McIlrath, Treasurer, Michael Stephens, Controller and with Donald Phillips, Partner, and Amy Hargrett, Manager, of the audit firm PricewaterhouseCoopers (PWC). At this meeting, the Audit Report of PricewaterhouseCoopers for the fiscal year ending June 30, 2001 was examined and discussed. Following the general discussion, the Audit Committee met in executive session, met with Donald Phillips and Amy Hargrett in separate session, met separately with Tom McIlrath, and then with Tom McIlrath and Michael Stephens. The Committee wishes to extend its thanks to Tom McIlrath and Michael Stephens for their cooperation and assistance in meeting the responsibilities of the Audit Committee.

The Audit Committee was provided with:

- The Audited APS Financial Statements for FY 2001 and 2000 and the Report of the Independent Accountants dated 9/26/01
- The PWC Report to Management of the APS dated 10/11/01
- The PWC Report to the Audit Committee dated 10/25/01
- The Report of the 2000 Audit Committee
- The APS charge to the Audit Committee dated 6/30/99

In addition to the formal audit issues, other topics were discussed that are included in the report below.

B. THE AUDIT REPORT

As noted by the audit firm, PricewaterhouseCoopers (see the "PWC Report to the Audit Committee" and the "APS Financial Statements for FY 2001 and 2000 and the Report of the Independent Accountants") the APS is in compliance with standard auditing requirements and the fiscal condition of the APS is sound and in accord with reasonable requirements for not-for-profit organizations. *The Audit Committee agrees with this conclusion.*

C. FOLLOW-UP ON THE RECOMMENDATIONS OF THE 2000 AUDIT COMMITTEE (*Comments of the current Audit Committee are in Italics*)

1. We recommend that the FY 2000 Independent Auditor's Report prepared by PricewaterhouseCoopers be accepted.

Council accepted report.

2. We find, on the basis of the audit by PWC and our discussions that there are no outstanding issues of importance in the financial affairs of the APS.

No follow-up required.

3. We recommend that the APS retain PricewaterhouseCoopers as the audit firm for FY 2001. The possibility of re-bidding audit responsibility should be reassessed each year.

PWC was retained.

In general, the selection of a new firm is based on a balance between good service and continuity (someone who gets to know the business) and the risk of establishing uncritical audits that can develop over long periods of mutual relationships. The APS has traditionally retained audit firms for periods longer than seven years and the cost of using PricewaterhouseCoopers has remained fairly constant. Further, after discussion with both the accountants and with Tom McIlrath and Michael Stephens, the Audit Committee (AC) feels that strong controls are in place to maintain a critical audit and that the APS is being provided with good service. The AC discussed the retention of PWC for FY2002. The AC was informed by management that the APS is going to adopt the calendar year as its new fiscal year. The transition will take place in 2002. The end of the current fiscal year system will be June 30, 2002. There will be an additional audit after the end of calendar year 2002, and then in the spring of each subsequent calendar year. The Audit Committee believes that there are compelling arguments for retaining the current auditing firm PWC through the transition period in 2002.

D. STATEMENTS BY PWC ABOUT THE FY 2001 AUDIT (Comment in Italics)

The following statement appears in the Report to Management by PWC:

“Improve controls in accounting for membership revenue

Due to inherent limitations, the current membership system (formerly Orange) does not produce detailed historical membership information that would provide an audit trail for the accounting of membership revenue. This information is important for management to be able to properly account for and verify deferred revenue at the individual membership level, and to ensure the system is correctly accounting for revenue over the life of the membership.

In its efforts to update or replace the current membership system, management should consider a system’s capabilities of producing detailed historical information on membership revenues that will generate an audit trail.”

Management’s Response: “The new Associate Management System (ASM) should provide convenient, accurate, and timely accounting reports on membership revenue including historical data as of any given date.”

Audit Committee Response: *Institution of these controls should be provided by any new Associate Management System (ASM).*

In response to direct questions from the Audit Committee, PWC's representatives stated that they found no unresolved issues in their audit.

E. RECOMMENDATIONS AND FINDINGS OF THE FY 2001 AUDIT COMMITTEE TO COUNCIL

- 1) *We recommend that the FY 2001 Independent Auditor's Report prepared by PricewaterhouseCoopers be accepted.*
- 2) *We find, on the basis of the audit by PWC and our discussions, that there are no outstanding issues of importance in the financial affairs of the APS.*
- 3) *We recommend that the APS retain PricewaterhouseCoopers as the audit firm for FY 2002 and through the six-month transition period to the new calendar fiscal year. The possibility of re-bidding audit responsibility should be reassessed in spring 2003 and every year after that.*