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Section 404 Reporting on Internal Control: Our Early Experience

Summary

Larger US public companies with calendar year ends have recently filed, for the first time, management and auditor reports on internal control as required by Section 404 of the Sarbanes-Oxley Act of 2002 (404 reports). This Special Comment summarizes our experience to date in evaluating the credit implications of those reports.

Fewer companies are reporting control problems than we had expected. Overall, about 5 percent of the companies we rate are reporting material weaknesses compared to the 10 to 20 percent of public companies that market speculation suggested would do so.

Companies reporting control problems are a diverse group, varying widely in industry, size and rating level. However, the average rating for the group (Ba3) was three notches below the average for all US companies we rate (Baa3).

In general, despite material weaknesses, we are finding that rating actions are not needed in many cases because:

- Control problems appear to be specific, localized and correctable within a short period
- The rating already reflects our impression of control weakness, or
- Management's plan for remediating the control problem appears credible.

To date, the most serious control problems we have considered reside in companies that are not able to complete their internal control reports by the SEC's deadline (delinquent filers group). In addition to control issues, some of the 17 companies in that group faced other accounting problems. The resulting arena of uncertainty surrounding their financial reporting has resulted in negative rating action in 10 cases. To date, rating actions have ranged from a change in outlook to a two notch downgrade. We have also taken negative rating actions related to internal controls in two other cases (not delinquent filers). In those cases, the control problems appeared pervasive and the companies faced other reporting problems. We remain in the early days of considering control weaknesses and further negative rating actions are possible in selective cases.

There are two areas where improved disclosure about controls would help creditors. First, companies with control problems could often be more specific about the nature of the control problems they report. Second, companies could be more specific about their plans to remediate control weaknesses and the timing for doing so. Creditors would welcome quarterly updates on progress toward remediation and an auditor's report on successful remediation of a control problem when the remediation occurs, rather than waiting until the next annual reporting cycle.

We believe that reports on internal control are a significant development in restoring investor confidence in financial reporting, which has been badly shaken in recent years. We perceive that companies are strengthening their accounting controls and investing in the infrastructure needed to support quality financial reporting. Most of the control problems disclosed in the reports do not appear to be new, and are coming to light because of closer scrutiny — not because new problems are occurring. In most cases, the control problems cited do not impact the company's credit risk. However, creditors should be alert to a company that reports more severe control problems, particularly when coupled with other concerns about its financial reporting, suggesting heightened risk for creditors.



Number of Companies Reporting Material Weaknesses

Of the 1800 US companies Moody's rates that have filed internal control reports, 76 (about 4%) have reported material weaknesses in internal control. An additional 17 companies we rate (about 1%) have been late filing their internal control reports with the SEC, in part due to control problems (we refer to these companies as delinquent filers¹). Appendix 1 lists the companies in the 404 report and delinquent categories.

Importantly, fewer companies are reporting material weaknesses than we had expected (we expected 10 to 20 percent of public companies, based on early speculation by auditors and companies).

It is possible that the percentage of companies reporting material weaknesses could increase. Over 200 companies, many of which are retailers with January 31 year ends that have yet to file 404 reports, have announced adjustments or restatements for errors in lease accounting. Many of these companies may report material weaknesses related to leasing. In addition, many smaller public companies, which have an extra 45 days to file 404 reports, have yet to file. Material weaknesses could be more prominent among smaller companies, with less formal controls and documentation.

Characteristics Of Companies Reporting Control Weaknesses

Companies reporting control problems are a diverse group, varying widely in industry, size and rating level.

The 93 companies reporting control problems are dispersed across 25 sectors with little concentration in any one sector.

Revenues vary widely ranging from over \$80 billion to under \$100 million. Average revenues are about \$1 billion, with a standard deviation of about \$900 million.

Rating levels range from Aaa to C. However, the average rating for the group with control problems is Ba3, which is three notches below the average for all US companies we rate (Baa3).

Nature Of Control Weaknesses

Moody's classifies material weaknesses in internal control as either Category A or B²:

- *Category A:* Weaknesses that relate to controls over specific account balances or transaction-level processes. In most cases, we believe that the auditor can effectively "audit around" these material weaknesses by performing additional substantive procedures in the area where the weakness exists. We typically give companies reporting Category A material weaknesses the benefit of the doubt and do not take any related rating action based solely on the fact of the reported weakness, assuming management takes corrective action to address it in a timely manner.
- *Category B:* Weaknesses that relate to company-level controls, such as an ineffective control environment, weak overall financial reporting processes, or ineffective personnel. We question the ability of the auditor to effectively "audit around" a Category B material weakness. In these cases, we generally bring a company to rating committee to determine whether a rating action is needed.

Category B weaknesses also include delinquent filers. Moody's believes that the inability to complete financial reporting on a timely basis is a company-level control weakness that generally merits rating committee consideration. We also include in Category B those companies that report several Category A weaknesses.

Of the 76 companies that have reported material weaknesses in 404 reports, we believe that 24 have disclosed company-level problems (Category B), while 52 have disclosed control problems with specific account balances or transaction-level processes (Category A). An additional 17 companies are delinquent filers, which we also classify in the B category.

Appendix 2(a) summarizes the nature of control weaknesses for each of the companies reporting control problems. Appendix 2(b) organizes this same data by type of weakness.

The most common type of Category A weaknesses relate to income taxes, lease accounting, revenues and related receivables and accrued liabilities. Taken together, these four areas represent over half of all Category A weaknesses, with the remainder spread across 19 other areas.

1. For our purposes, delinquent filers exclude the many companies that took advantage of the 15 day grace period from March 15 to March 31 for filing their financial statements and internal control reports.

2. See our Special Comment, *Section 404 Reports on Internal Control: Impact on Ratings Will Depend on Nature of Material Weakness Reported*, dated October 2004.

Accounting for income taxes is often complex, and some companies have traditionally relied on their auditors to advise and assist company personnel. However, auditor reliance is not permitted, and some companies are struggling to build in-house competence. In 2004, auditors and the SEC called attention to certain features of lease transactions that many companies had accounted for incorrectly. As a result, over 200 companies have announced adjustments or restatements for errors in lease accounting, and many of those companies have reported or will report related control weaknesses. Revenue recognition sometimes involves complex issues and judgements and has been a frequent source of restatements. Accrued liabilities often involve estimates, judgments and non-routine transactions or events, increasing the risk of error.

The most common type of Category B weakness relates to ineffective or insufficient accounting personnel in company wide functions, and the inability to complete financial reporting on a timely basis (delinquent filers). Together, these categories represent about 80 percent of the Category B weaknesses.

Insufficient accounting skills or capacity among accounting personnel reflects an underinvestment in the infrastructure needed for quality reporting. In an effort to improve efficiency or take advantage of technology, some companies have apparently under-staffed their accounting functions in recent years. For complex or non-routine areas, they relied on their auditors for help, rather than building in-house competence. Section 404 reports are bringing attention to this problem, which has inspired companies to reinvest in accounting personnel.

Impact Of Control Weaknesses On Moody's Ratings

The following table summarizes the impact of control weaknesses to date:

Status	Delinquent Filers	Category B	Category A	Total
Rating committee discussion	11	8	0	19 ³
No rating committee discussion	6 ⁴	16 ⁴	52	74
Total	17	24	52	93
Rating action	10	2	0	12

To date, we have taken rating action, in part because of control problems, in 12 of 93 companies. In general, despite material weaknesses, we are finding that rating actions are not needed because:

- Control problems appear to be specific, localized and correctable within a short period (Category A)
- The rating already reflects our impression of control weakness, or
- Management's plan for remediating the control problem appears to be credible.

Much of the news about control problems is new, and rating committees have yet to discuss many companies falling in the delinquent and Category B classifications.

Generally, the most serious control problems reside in the delinquent filers group. In addition to control issues, some of the 17 companies in that group faced restatements of financial statements, accounting investigations, and questions about when they could file financial statements or control reports. This combination of issues has created considerable uncertainty surrounding their financial reporting. To date, we have taken negative rating action in 10 of the 11 delinquent filers that rating committees have discussed. We have also taken negative rating actions related to internal controls in two other cases (not delinquent filers). In those cases, the control problems appeared pervasive and the companies faced other reporting problems.

Our rating actions range from a change in outlook to a two notch downgrade, distributed as follows:

Rating Action	Companies
Lower rating outlook	4
Review for downgrade	2
1 notch downgrade	2
1 notch downgrade and lower outlook	2
1 notch downgrade and review for downgrade	1
2 notch downgrade	1
Rating actions	12

³ Appendix 3 lists the actions rating committees have taken to date when discussing delinquent filers and Category B control weaknesses.

⁴ Additional rating committee discussions are pending.

While we are still in the early days of considering control weaknesses, our experience thus far suggests the following. For a company reporting Category B weaknesses, we are more likely to take rating action when several of the following factors are present:

- The company is delinquent filing its control reports, and there is uncertainty about when it will be able to do so, thereby jeopardizing access to the capital markets and possibly tripping debt covenants⁵
- The company has a history of reporting problems and the issues don't seem to be getting better
- The company has adopted aggressive accounting practices or engaged in misleading reporting
- The company faces investigations into its accounting practices and there are pending restatements of uncertain amounts
- The company's credit rating does not yet fully reflect increased risk of uncertainty about the company's financial reporting, or
- Management's plan to remediate the control problem is not yet credible because of management's inability to deal with similar problems in the past or inexperience in dealing with control problems.

Areas For Improvement And The Way Forward

There are two areas where improved disclosure about controls would help creditors:

- First, companies with control problems could often be more specific about the nature of the control problem they report. Vague generalizations raise more questions than they address. More detail would help creditors understand the relative severity of control problems and would reduce the uncertainty about a company's financial reporting.
- Second, companies could be more specific about their plans to remediate control weaknesses and the timing for doing so. Some companies disclose little about their remediation plans. Creditors want to be sure that management is taking its control problems seriously and that timely correction is underway.

Looking forward, we expect that many companies will update creditors in their quarterly filings on their progress toward remediation of control weaknesses. We welcome those updates. We would also welcome an auditor's report on successful remediation of a control problem when the remediation occurs, rather than waiting until the next annual reporting cycle. Accordingly, we were pleased with the Public Company Accounting Oversight Board's recent proposal to allow auditors to report on successful remediation on an interim basis.

We believe that reports on internal control are a significant development in restoring investor confidence in financial reporting, which has been badly shaken in recent years. We perceive that companies are strengthening their accounting controls and investing in the infrastructure needed to support quality financial reporting. Most of the control problems disclosed in the reports do not appear to be new, and are coming to light because of closer scrutiny — not because new problems are occurring. In most cases, the control problems cited do not impact the company's credit risk. However, creditors should be alert to a company that reports more severe control problems, particularly when coupled with other concerns about its financial reporting, suggesting heightened risk for creditors.

⁵ See our Special Comment, *Credit Implications for Companies that Fail to File Internal Control Reports on Time*, dated March 2005.

Appendix 1
Characteristics of Companies Reporting Control Weaknesses
As of April 1, 2005

Company	Severity	Industry	Revenue (MM)	Rating	
Delinquent Filers:			2003		
Aaipharma, Inc.	B	Pharmaceuticals	\$224	Caa2	STA
American International Group, Inc.	B	Insurance	\$81,303	Aa1	RUR
BearingPoint, Inc.	B	Miscellaneous	\$1,554	Ba3	NEG
Ceridian Corporation	B	IT	\$1,213	Baa3	NEG
Delphi Corporation	B	Automotive Parts	\$28,096	Ba2	RUR
Fannie Mae (Federal National Mortgage Association)	B	Sovereign Related Financial Co.	\$53,768	Aaa	STA
Flowserve Corporation	B	Mechanical Components	\$2,404	Ba3	STA
Healthcare Realty Trust Incorporated	B	REIT	\$191	Baa3	STA
Highwoods Properties, Inc.	B	REIT	\$504	Ba1	STA
Integrated Alarm Services Group, Inc.	B	Consumer Electronics	\$40	B3	RUR
Interpublic Group of Companies, Inc.	B	Advertising	\$5,863	Baa3	RUR
Key Energy Services, Inc.	B	Industrial Gas	\$803	B1	RUR
Nortel Networks Corporation	B	Telecomm Equipment	\$10,193	B3	RUR
Shurgard Storage Centers ¹	B	REIT	\$425	Baa3	NEG
Southern Union Company	2	Gas Transmission and Distribution	\$1,800	Baa3	NEG
Terex Corporation	B	Industrial Machinery	\$3,897	B1	STA
United Rentals North America, Inc.	B	Industrial Construction	\$2,897	B1	STA
Vesta Insurance Group, Inc.	B	Insurance Holding Company	\$617	B2	STA
Companies Reporting Material Weaknesses in Section 404 Reports:			2004		
AES Corporation	A	Independent Power Holding Co.	\$9,486	B1	STA
Alcan, Inc.	A	Industrial Metals/Mining	\$24,885	Baa1	STA
Aleris International, Inc.	B	Metals/Mining	\$1,226	B2	STA
Alpharma, Inc.	B	Pharmaceuticals	\$1,297	B3	STA
America West Airlines, Inc.	A	Airline Transportation	\$2,338	Caa2	STA
American Tower Corporation	A	Telecommunications	\$715	B3	POS
Baxter International, Inc.	A	Hospital Supplies	\$9,509	Baa1	NEG
Blockbuster, Inc.	A	Retail	\$5,911	Ba3	NEG
BRE Properties, Inc.	A	REIT	\$280	Baa2	STA
Calpine Corporation	A	Independent Power Holding Co.	\$8,919	Caa1	STA
Central European Media Enterprises Ltd.	A	Media	\$182	B2	POS
Chiron Corporation	A	Drugs/Cosmetics	\$1,723	Baa2	NEG
CIT Group, Inc.	A	Non-Captive Finance	\$4,718	A2	STA
Clean Harbors, Inc.	A	Waste Management	\$610	B2	STA
Compass Minerals Group, Inc.	A	Metals/Mining	\$695	B1	STA
Countrywide Financial Corp.	A	Mortgage Finance	\$11,246	A3	STA
Covanta Energy Corporation	B	Diversified Energy Holding Co.	\$700	B3	RUR
Crescent Real Estate Equities Company	A	REIT	\$978	B3	NEG
Crompton Corporation	A	Industrial Chemicals	\$2,549	B1	RUR
Crown Castle International Corp.	A	Telecommunications	\$930	B3	RUR
Denny's Corporation	A	Restaurant/Fast Food	\$960	B2	STA
Dynegy, Incorporated	A	Gas Transmission	\$6,153	Ca	POS
Eastman Kodak Company	A	Photo/Optical	\$13,317	Baa3	RUR
El Paso Corporation	B	Gas Transmission	\$5,874	Caa1	STA
First Industrial, L.P.	A	REIT	\$275	Baa2	STA
Foster Wheeler Ltd.	A	Construction	\$2,661	C	NEG
Friendly Ice Cream Corp.	A	Restaurant/Fast Food	\$574	B2	STA
GEO Group, Inc.	B	Real Estate Finance	\$614	B1	STA
Goodyear Tire and Rubber Company	B	Tires	\$18,370	B3	NEG
Grant Prideco, Inc.	A	Oil Pipeline	\$945	Ba3	STA
Green Mountain Power Corporation	A	Integrated Electric Utility	\$228	Baa1	STA
Hecla Mining Company	A	Metals/Mining	\$130	Caa1	STA

¹ Shurgard Storage centers filed its form 10-K, but did not include its report on internal control and related audit opinion on internal control.

² Southern Union Company's delay in filing its Section 404 Report comes from a change in fiscal year-end from June 30 to December 31. The company's change to a calendar year-end reporting period had the effect of accelerating, from June 30, 2005 to December 31, 2004, the first date for which the company must comply with the requirements of Section 404. The company does not plan to disclose any material weaknesses.

Appendix 1
Characteristics of Companies Reporting Control Weaknesses
As of April 1, 2005

Company	Severity	Industry	Revenue (MM)	Rating	
Hertz Corporation	A	Automotive	\$9,123	Baa2	RUR
Hollywood Entertainment Corporation	A	Entertainment	\$1,782	B1	RUR
Horace Mann Educators Corporation	A	Insurance: Multi-Line	\$878	Baa3	STA
INFOUSA, Inc.	B	Computer Services	\$344	Ba3	STA
International Steel Group, Inc.	B	Steel	\$9,015	Ba3	RUR
Inverness Medical Innovations, Inc.	A	Healthcare Service/Equipment	\$376	B2	NEG
King Pharmaceuticals, Inc.	B	Drugs/Cosmetics	\$1,304	Ba3	RUR
Manitowoc Company, Inc.	A	Food/Soft Drinks	\$1,964	B1	STA
Masco Corporation	B	Building Materials	\$12,074	Baa1	STA
MasTec, Inc.	A	Industrial	\$913	Ba3	NEG
Maxtor Corporation	B	Electrical Components	\$3,796	B2	STA
McDermott International, Inc.	B	Oil Service	\$2,335	Caa1	NEG
MCI, Inc.	A	Telecommunications	\$20,690	B2	RUR
MeadWestvaco Corp.	A	Paper Products	\$8,227	Baa2	STA
Meritage Homes Corporation	A	Home Building	\$2,040	Ba3	POS
New York Community Bancorp, Inc.	A	Thrift Holding Company	\$1,282	Baa1	RUR
Northeast Utilities	A	Electric Holding Company	\$6,686	Baa2	STA
NorthWestern Corporation	A	Diversity Holding Company	\$205	Ba1	STA
OfficeMax, Inc.	B	Office Supplies & Paper Products	\$13,270	Ba1	STA
Pacific Capital Bancorp	B	U.S. Bank Holding Company	\$335	A3	STA
Paxson Communications Corporation	A	Broadcasting	\$276	B2	STA
Pope & Talbot, Inc.	A	Forest Products/Paper	\$762	Ba3	STA
Pride International, Inc.	B	Oil Service	\$1,712	Ba2	STA
Providian Financial Corporation	A	Finance - Non Captive	\$2,781	B2	RUR
Radiologix, Inc.	A	Healthcare Services	\$251	B2	STA
Riggs National Corporation	B	U.S. Bank Holding Company	\$328	B2	RUR
SBA Communications Corporation	A	Telecommunications	\$65	Caa1	STA
Scientific Games Corporation	B	Casino Games	\$725	Ba2	STA
Scottish Re Group Ltd.	A	Reinsurance	\$811	Baa2	NEG
Sea Containers Ltd.	B	Transportation Equip Leasing	\$1,742	B3	NEG
Sensient Technologies Corporation	A	Food/Soft Drinks	\$1,047	Ba1	STA
Sequa Corporation	A	Industrial Machinery	\$1,864	B1	STA
Service Corporation International	B	Funeral Services	\$1,859	Ba3	STA
Spectrasite, Inc.	A	Telecommunications	\$335	B2	POS
Standard Motor Parts, Inc.	B	Automotive Parts	\$714	B1	STA
SunTrust Banks, Inc.	B	U.S. Bank Holding Company	\$6,289	Aa3	NEG
Thermadyne Holdings Corporation	B	Industrial Machinery	\$482	B2	STA
UCBH Holdings, Inc.	B	U.S. Bank Holding Company	\$238	Baa2	STA
US Unwired, Inc.	A	Telecommunications	\$594	B3	STA
USEC, Inc.	A	Industrial Chemicals	\$1,417	Ba3	RUR
USI Holdings Corporation	A	Insurance Brokerage	\$407	B1	STA
Vishay Intertechnology, Inc.	B	Electronics	\$2,413	B1	STA
Visteon Corporation	A	Automotive Parts	\$18,657	Ba2	RUR
Western Wireless Corporation	A	Cellular Telephone	\$1,917	Caa1	RUR

Rating: Moody's Senior Unsecured, when unavailable, Senior Implied.

Appendix 2(a)
Nature of Control Weakness by Company
As of April 1, 2005

Company	Nature of Control Weakness
Delinquent Filers:	
Aaipharma, Inc.	Ineffective personnel
American International Group, Inc.	Characterization of material weakness not yet disclosed.
BearingPoint, Inc.	Various significant deficiencies that constituted a material weakness
Ceridian Corporation	Accruals, Fixed assets - other
Delphi Corporation	Revenue recognition ¹ , Off-balance sheet financing
Fannie Mae (Federal National Mortgage Association)	Derivative accounting, Lease accounting, Loans - Indirect Costs
Flowserve Corporation	Characterization of material weakness not yet disclosed.
Healthcare Realty Trust Incorporated	Characterization of material weakness not yet disclosed.
Highwoods Properties, Inc.	Characterization of material weakness not yet disclosed.
Integrated Alarm Services Group, Inc.	Characterization of material weakness not yet disclosed.
Interpublic Group of Companies, Inc.	Characterization of material weakness not yet disclosed.
Key Energy Services, Inc.	Characterization of material weakness not yet disclosed.
Nortel Networks Corporation	Lease accounting
Shurgard Storage Centers	Ineffective personnel, Pervasive ineffective processes
Southern Union Company	No material weakness expected.
Terex Corporation	Specific intercompany accounts
United Rentals North America, Inc.	Accruals, Income tax accounting, Inventory accounting
Vesta Insurance Group, Inc.	Characterization of material weakness not yet disclosed.
Companies Reporting Material Weakness in 404 Reports:	
AES Corporation	Income tax accounting
Alcan, Inc.	Impairments
Aleris International, Inc.	Derivative accounting, Interest costs- debt, Pension
Alpharma, Inc.	Revenues and related receivables, Accruals, Income tax accounting, Segment reporting
America West Airlines, Inc.	Derivative accounting
American Tower Corporation	Leases accounting
Baxter International, Inc.	Income tax accounting
Blockbuster, Inc.	Lease accounting.
BRE Properties Inc.	Accruals and accounts payable
Calpine Corporation	Income tax accounting
Central European Media Enterprises, Ltd.	Financial instruments - debt vs. equity classification
Chiron Corporation	Accruals, Income tax accounting, Revenue recognition
CIT Group, Inc.	Income tax accounting
Clean Harbors, Inc.	Accruals
Compass Minerals Group, Inc.	Income tax accounting
Countrywide Financial Corp.	Securitization accounting
Covanta Energy Corporation	Ineffective personnel
Crescent Real Estate Equities Company	Accounts payable, Accounts receivable
Crompton Corporation	Income tax accounting
Crown Castle International Corp.	Lease accounting
Denny's Corp.	Lease accounting
Dynegy Incorporated	Income tax accounting
Eastman Kodak Company	Income tax accounting, OPEB, Pension
El Paso Corporation	Technology controls, Fixed assets -other, Impairments, Investment accounting, Various significant deficiencies that constituted a material weakness
First Industrial, L.P.	Income tax accounting
Foster Wheeler Ltd.	Financial information accumulation - Small subsidiary
Friendly Ice Cream Corp.	Lease accounting.
GEO Group, Inc.	Accruals, Income tax accounting, Investment accounting, Lease accounting
Goodyear Tire and Rubber Company	Data access, Various significant deficiencies that constituted a material weakness
Grant Prideco, Inc.	Revenue recognition
Green Mountain Power Corporation	Income tax accounting
Hecla Mining Company	Accounts payable, Inventory accounting
Hertz Corporation	Revenue recognition
Hollywood Entertainment Corporation	Lease accounting

¹ This material weakness related to rebate accounting, which was deemed to be a revenue recognition matter for purposes of this report.

Appendix 2(a)
Nature of Control Weakness by Company
As of April 1, 2005

Company	Nature of Control Weakness
Horace Mann Educators Corporation	Cash, Income tax accounting
INFOUSA, Inc.	Ineffective personnel, Impairments
International Steel Group, Inc.	Revenue recognition, Access controls, Inventory accounting
Inverness Medical Innovations, Inc.	Acquisition accounting, Income tax accounting
King Pharmaceuticals, Inc.	Ineffective personnel
Manitowac Company, Inc.	Foreign exchange accounting
Masco Corporation	Pervasive ineffective processes
MasTec, Inc.	Inventory accounting
Maxtor Corporation	Ineffective personnel, Pervasive ineffective processes, Accruals, Acquisition accounting
McDermott International, Inc.	Aggressive critical accounting policy, Data Access, Various significant deficiencies that constituted a material weakness
MCI, Inc.	Income tax accounting
MeadWestvaco Corp.	Income tax accounting
Meritage Homes Corporation	Lease accounting
New York Community Bancorp, Inc.	Income tax accounting
Northeast Utilities	Derivative accounting
NorthWestern Corporation	Derivative accounting
OfficeMax, Inc.	Pervasive ineffective processes, Ineffective personnel
Pacific Capital Bancorp	Pervasive ineffective processes, Ineffective Personnel
Paxson Communications Corporation	Lease accounting
Pope & Talbot, Inc.	Income tax accounting
Pride International, Inc.	Ineffective personnel, Pervasive ineffective processes
Providian Financial Corporation	Securitization accounting
Radiologix, Inc.	Revenue recognition and related receivables
Riggs National Corporation	Ineffective personnel, Pervasive ineffective processes
SBA Communications Corporation	Lease accounting
Scientific Games Corporation	Ineffective personnel
Scottish Re Group Ltd.	Financial Reporting Process - Small Subsidiary
Sea Containers Ltd.	Ineffective personnel
Sensient Technologies Corporation	Impairments
Sequa Corporation	Revenue recognition
Service Corporation International	Revenues and related receivables, Lease accounting, Inventory accounting, Accounts payable.
Spectrasite, Inc.	Lease accounting
Standard Motor Parts, Inc.	Ineffective personnel, Technology controls, Various significant deficiencies that constituted a material weakness
SunTrust Banks, Inc.	Revenues and related receivables
Thermadyne Holdings Corporation	Financial information accumulation - small subsidiaries, Income tax accounting, Inventory Accounting, Fixed assets - other
UCBH Holdings, Inc.	Ineffective personnel
US Unwired, Inc.	Lease accounting
USEC, Inc.	Revenue Recognition, Income tax accounting
USI Holdings Corporation	Various significant deficiencies that constituted a material weakness
Vishay Intertechnology, Inc.	Ineffective personnel
Visteon Corporation	Fixed assets - other, OPEB
Western Wireless Corporation	Income tax accounting

Appendix 2(b)
Nature of Control Weakness by Type of Weakness
As of April 1, 2005

Nature of Control Weakness	Severity	Number of Companies	Percentage of Weaknesses	Percentage of Severity Group
Aggressive critical accounting policies	B	1	1%	3%
Delinquent Filers	B	17	11%	42%
Ineffective Personnel	B	16	10%	40%
Pervasive ineffective processes	B	6	4%	15%
Financial Reporting Process -- Small Subsidiary	A	1	1%	1%
Accounts payable and accrued liabilities	A	11	7%	10%
Acquisition accounting	A	2	1%	2%
Cash	A	1	1%	1%
Derivative accounting	A	5	3%	4%
Financial information accumulation - small subsidiaries	A	2	1%	2%
Financial instruments - SFAS 150	A	1	1%	1%
Fixed assets - other	A	4	3%	4%
Foreign exchange accounting	A	1	1%	1%
Impairments - various types	A	4	3%	4%
Income tax accounting	A	23	15%	21%
Interest costs - debt	A	1	1%	1%
Inventory accounting	A	6	4%	5%
Investment accounting	A	2	1%	2%
Lease accounting	A	15	10%	14%
Loans - indirect costs	A	1	1%	1%
Off-balance sheet financing	A	1	1%	1%
Pension & OPEB	A	3	2%	2%
Revenues and related receivables	A	12	8%	11%
Securitization accounting	A	2	1%	2%
Specific inter-company accounts	A	1	1%	1%
Technology and data access	A	4	3%	4%
Various significant deficiencies that constituted a Material Weakness	A	6	4%	5%
Total Material Weaknesses ¹		149		
Total Category B Material Weaknesses		40		
Total Category A Material Weaknesses		109		

¹ This figure is greater than the total number of companies reporting material weaknesses because some companies report several material weaknesses.

Appendix 3 Impact of Control Weaknesses on Moody's Ratings As of April 1, 2005

Alpharama, Inc.	None	Rating already reflects material weakness.
American International Group, Inc.	Long-term senior debt to Aa1 from Aaa Review for downgrade	<p>This rating action follows the company's announcement yesterday that it would delay the filing of its 2004 Form 10-K with the Securities and Exchange Commission in order to complete an extensive financial review. The announcement also highlighted a number of areas of specific concern, based on internal and external investigations to-date. Significantly, ongoing regulatory investigations into the company's business and internal reviews at AIG, have indicated that several transactions appear to have been put in place primarily to enhance reported financial results. The magnitude of possible financial adjustments or restatements of prior year results is now estimated by AIG to be as much as 2% of its shareholders equity, or approximately \$1.7 billion after tax.</p> <p>Moody's said that these findings are suggestive of a culture of financial aggressiveness and of control inadequacies that are inconsistent with disciplines of internal control, risk management, corporate governance, and a commitment to financial conservatism that is typical at the Aaa rating level. However, Moody's notes that AIG's Board has acted quickly to address these issues through an intensive internal review and associated management changes.</p>
BearingPoint, Inc.	Senior implied rating to Ba2 from Ba1 Senior Unsecured issuer rating to Ba3 from Ba2 Negative outlook	<p>The rating action reflects heightened uncertainty of the company's ability to manage its global operations effectively through adequate internal controls and financial reporting processes. The action also considers Moody's expectation for a prolonged timeframe for improving profitability and management of its cost structure and business practices.</p> <p>The negative outlook considers the near term challenges BearingPoint faces with respect to: (i) the sufficiency of its internal controls, financial policies and financial reporting; (ii) amendments to and reductions in the size of its interim credit facility; (iii) achievement of adequate sustained profitability and (iv) limited improvement in the operational and financial performance of its international businesses.</p>
Ceridian Corporation	Rating Outlook to negative from stable	The negative outlook reflects uncertainties associated with the expanded scope of the company's financial restatements and deficiencies in the company's internal control, which suggest more pervasive accounting control issues than Moody's previously envisioned.
Delphi Corporation ¹	Senior unsecured to Ba2 from Baa3	The rating downgrade reflects Moody's belief that because of the ongoing investigation of improper accounting practices at the company, heightened concerns over the adequacy of internal controls, and significant changes in management occurring at a time when the company is facing greater competitive and business challenges, Delphi's overall credit quality is not consistent with the maintenance of an investment grade rating.
El Paso Corporation	None	Rating already reflects material weakness
Fannie Mae (Federal National Mortgage Association)	Bank Financial Strength Rating from A- to B+ with a stable outlook.	Moody's said that the conclusion of its review of Fannie Mae's Bank Financial Strength Rating follows the company's recent announcement of several additional accounting and internal control issues identified by the Office of Federal Housing Enterprise Oversight (OFHEO), Fannie Mae's regulator. The investigation by OFHEO is ongoing. The new findings may result in the recognition of additional losses adversely impacting regulatory capital in the short term and require improvement of additional internal controls. More importantly, the identification of additional accounting and internal control issues, along with the continuing regulatory and related investigations, may be suggestive of larger governance and control problems.
Goodyear Tire and Rubber Company ²	Rating Outlook held at negative	The outlook was kept negative to reflect uncertainties and prospective delays associated with the company's need to restate previous financial statements, a conclusion by its auditors on internal control matters, and a lingering SEC investigation. These matters may be resolved in the near future, whereupon the outlook will be revisited.

¹ A rating committee was held prior to the company's public announcement that it would be a delinquent filer. However, the rating committee considered the fact that Delphi would likely not meet the filing deadline for its Form 10-K. Subsequent to the rating committee, the company announced it substantially completed its internal investigation.

² A rating committee was held to assign a rating to a new debt issue. This rating committee was held prior to the company's filing of its Form 10-K and related report on internal control. The committee's action was based on the expectation that Goodyear would be a delinquent filer and report a Category B material weakness. However, the company did meet the filing deadline for its Form 10-K and reported a Category B material weakness.

Appendix 3
Impact of Control Weaknesses on Moody's Ratings
As of April 1, 2005

Integrated Alarm Services Group, Inc.	Review for downgrade	The review for possible downgrade reflects Moody's concern about the possible acceleration of the maturity of the company's \$125 million senior secured second lien notes, management's inability to file its annual report on Form 10-K and complete its evaluation of internal controls over financial reporting, and the potential scope of material weaknesses in internal controls at the company.
Interpublic Group of Companies, Inc.	Review for downgrade	The review follows the company's announcement that its annual report will be filed late, at some point subsequent to the SEC's extended deadline of March 31st, due to delays in completing testing required by section 404 of the Sarbanes-Oxley Act, along with the possible restatement of prior period financial statements. This announcement comes after prior disclosures of identified material weaknesses in internal controls, tempered by management's commitment to remediation efforts.
Key Energy Services, Inc.	None	Rating already reflects material weakness.
McDermott International, Inc.	None	Rating already reflects material weakness.
Pacific Capital Bancorp	None	Management's plan for remediation deemed credible.
Pride International, Inc.	No Rating Action taken on Section 404 disclosures.	The rating already reflects material weaknesses. While fundamental gains justify a move up to stable outlook, we do not see further rating gains until Pride receives third party validation that it has gained adequate control over internal accounting systems, controls, and reporting, and substantially further reduces adjusted debt and lease-adjusted debt.
Shurgard Storage Centers	Review for downgrade Senior unsecured debt shelf to (P) Baa3 from (P) Baa2 Rating Outlook to negative	The rating downgrade reflects a series of accounting and control difficulties, most recently culminating in the REIT's inability to complete its Section 404 compliance requirements on time, and the negative impact that this could have on Shurgard's performance. The negative outlook reflects persistent control and accounting weaknesses at the REIT and the potential for further accounting- and control-related difficulties. Strengthening its accounting and controls will take time and resources, and this may divert attention from the core business.
SunTrust Banks, Inc.	Rating Outlook to negative from stable	The change in outlook reflects Moody's concern that internal control failures were broader than initially anticipated.
Terex Corporation	Speculative grade liquidity rating to SGL-2 from SGL-1	The SGL-2 rating reflects the company's ongoing good liquidity profile with significant balance sheet cash and strong operating cash flows. Nevertheless, because of an ongoing effort to resolve an imbalance in certain inter-company accounts, the company has not yet published its third quarter 10Q with the SEC. While this has not impaired the company's access to its bank credit facilities, any protracted delays in filing financial statements could necessitate obtaining bank waivers in the future. While it is likely that such waivers could be obtained, the current uncertainty as to the resolution of the imbalances and the timing of filing financial statements has the potential to diminish the company's financial flexibility if not resolved in a timely manner. The company has indicated that the net imbalance involved is \$11 million, but the ultimate resolution could have impacts greater or lesser than the \$11 million on individual line items of any affected financial statements.
UCBH Holdings, Inc.	None	Management's plan for remediation deemed credible.
United Rentals North America, Inc.	Rating Outlook to negative from stable	The negative outlook reflects the uncertainty regarding the ongoing SEC inquiry into a broad range of URI's accounting practices. The rating action follows the company's announcement of its delay in filing its 2004 10K due in part to the SEC inquiry. While the company has received bank waivers through June 29, 2005 reflecting the delay, the current uncertainty as to the resolution of the SEC inquiry and the timing of filing financial statements has the potential to diminish the company's financial flexibility if not resolved in a timely manner.
Vishay Intertechnology, Inc.	None	Rating already reflects material weakness

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