

December 19, 2006

**STATEMENT BY BOARD MEMBER BILL GRADISON**

I first want to indicate my full support for the new internal control standard – Accounting Standard 5 – which will replace Accounting Standard 2. It’s not often that a regulator acknowledges so quickly that its rules need to be rewritten, but that’s just what’s happening today. And while the Board can justifiably take a bow for its willingness to learn from the experience under AS2 and support a major mid-course correction, my hat is off to our staff and my Board colleagues that, with good cheer, great patience, and enormous professional skill actually produced AS5.

I think it is useful to step back from the specifics and consider where this focus on internal controls came from. Not surprisingly, my thoughts are influenced by my past experience, in this case having served in the Congress. In that past life, I voted for the Foreign Corrupt Practices Act in 1977 which, among other things, mandated that all public companies have adequate internal controls. I also voted for passage of the Federal Deposit Insurance Corporation Improvement Act of 1991 which, in Section 112, provides requirements for management and for independent public accountants with regard to internal controls at large banks. I was not in the Congress when Sarbanes-Oxley was passed, but I note that it included not only Section 404, which is virtually identical to FDICIA 112, but also Section 103, which requires this Board to adopt a standard dealing with the auditor’s responsibilities in connection with testing, evaluating, and reporting on a public company’s internal controls.

What I find striking about this history is that there was overwhelming support in the House for all three measures – the vote on the FCPA was 349-0, on FDICIA it was 344-84, and there were only three nay votes on Sarbanes-Oxley. Whatever one thinks about Sections 103 and 404, it’s hard to argue in view of the legislative history that Congress acted hastily on internal controls. What the history says to me is that PCAOB has clear direction from Congress to make sure that auditors take a much harder look at internal controls than they did pre-Sarbanes-Oxley. One could even interpret Sections 103 and 404 to be saying, “We’ve legislated on internal controls before, not enough has been done, and this time we really mean it.”

Our new standard takes this process one step further, still seeking to get the job done, but at lower cost. Several questions arise from this approach, one being when will we know if we are succeeding? With respect to accelerated filers, I would expect it would be in the Spring of 2008 for calendar year issuers. For non-accelerated filers – under the present SEC timetable – it would be the Spring of 2009 and maybe later, since the first year is often the high-water mark for costs. If I’m right about this timetable, there is going to be a strong need for patience, a commodity often in short supply when Sections 103 and 404 are discussed.

This leads me to the matter of costs and more specifically to the cost-benefit equation. It is completely understandable that from the point of view of an individual public company their concern is about how the costs to them compare with the benefits to them. From a public policy point of view, however, the costs of faulty internal controls affect not only the issuer (say, Enron or WorldCom) but also markets in general, which is to say investors. In judging over time whether we have struck the right cost-benefit balance, the focus of the discussion should be not only on the cost-benefit impact for individual issuers, but also on the broader public interest of investors. I believe this perspective is most consistent with the purpose clause of Sarbanes-Oxley: “To protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws...”

Today’s action is an important step in the standard-writing process, but in many ways the next steps are even more important: receiving and analyzing public comments, modifying the proposed standard where appropriate and, of course, review (and hopefully approval) by the SEC. This then is the end of the beginning for replacing AS2, an important action and one I am pleased to support.