

The thoughts of Chairman Olson

A summary of public statements by PCAOB chairman Mark Olson

About this document

InSights is produced by Tapestry Networks to provide assessments of key issues of interest to audit committees. Initially, *InSights* will be distributed to network members who, in turn, will share it with colleagues on audit committees and boards, and their advisers. It will be distributed by Ernst & Young to its partners. Anyone who receives *InSights* may share it with those in their own network. The ultimate value of *InSights* lies in its power to help all constituencies develop their own informed points of view.

Why review Chairman Olson's public statements?

The Public Company Accounting Oversight Board (PCAOB) is a private-sector, nonprofit corporation, created by the Sarbanes-Oxley Act of 2002 to oversee the auditors of public companies in order to protect the interests of investors and further the public interest in the preparation of informative, fair, and independent audit reports.

Since becoming chairman of the PCAOB in July 2006, Mr. Olson has continued efforts, initiated by his predecessor, to address the concerns of many issuers, auditors, and other interested parties, including the debate over replacing Auditing Standard No. 2 on internal controls over financial reporting with a new Auditing Standard No. 5. [For more information about that proposal, please see the Appendix on page 7.](#)

Chairman Olson has also fostered close relations with the Securities and Exchange Commission (SEC) and increased the presence of the PCAOB in the corporate governance community. Moving forward, Chairman Olson is committed to furthering the PCAOB's mission to protect the interests of investors and promote confidence in U.S. capital markets by working to ensure that public companies and their shareholders receive informative, fair, and independent audit reports..

To help audit committee chairs gain a deeper understanding of Chairman Olson's views and priorities, Tapestry Networks has summarized some of the key themes of the public speeches and interviews he has given since taking the helm of the PCAOB.

Biography¹

Mark W. Olson was born on March 17, 1943, in Fergus Falls, Minnesota. He received a BA in economics from St. Olaf College in 1965.

In the 1970s, Mr. Olson served Representative Bill Frenzel of Minnesota as legislative assistant for banking issues (1971–72) and as director of Rep. Frenzel's Minnesota district office (1974–76).

¹ This biography is adapted from the biography of Chairman Olson that is available at the PCAOB website at http://www.pcaobus.com/About_the_PCAOB/The_Board/Mark_W_Olson.aspx.

Mr. Olson began his banking career in 1966 with First Bank System (now U.S. Bancorp) and was named an officer in 1969. From 1976 to 1988, Mr. Olson was president and CEO of Security State Bank, Fergus Falls, Minnesota; in 1986 he was also elected president of the American Bankers Association.

From 1988 to 1999, Mr. Olson was a partner with Ernst & Young LLP and its predecessor, Arthur Young & Company, where he served as national director of the firm's regulatory consulting practice for the financial services industry. In addition, Mr. Olson was selected to join a 1991–92 Treasury Department effort to assist Eastern European bankers in adapting to a free-market economy.

From 2000 to 2001, Mr. Olson held the post of staff director of the securities subcommittee of the Senate Committee on Banking, Housing, and Urban Affairs. The subcommittee's legislative jurisdiction included the Securities and Exchange Commission, accounting policy issues, and the insurance industry.

In December 2001 he became a member of the Board of Governors of the Federal Reserve and the Federal Open Market Committee; in August of the following year he became administrative governor of the Federal Reserve Board. In 2003, St. Olaf College named Mr. Olson a distinguished alumnus. He became chairman of the Public Company Accounting Oversight Board on July 3, 2006.

Summary of public statements

Appointment as PCAOB chairman

"I am pleased and honored that the Securities and Exchange Commission selected me to serve as chairman of the Public Company Accounting Oversight Board ... I look forward to working with my colleagues on the PCAOB in their vital mission of ensuring informative, fair, and independent auditing of publicly traded companies."

U.S. Securities and Exchange Commission, "Federal Reserve Governor Mark W. Olson Named to Chair Public Company Accounting Oversight Board," press release, June 19, 2006²

Sarbanes-Oxley

"It is worth taking another look at the four years since scandals rocked investor confidence and led to the passage of the Sarbanes-Oxley Act to gauge the extent to which investors are recognizing improvements in the reliability of financial reporting by U.S. public companies. In some ways, the Act codified best practices that had begun to emerge immediately following the scandals."

Speech to the Financial Executives International Shaping the Future of Financial Reporting Conference, New York, NY, November 17, 2006³

² Available at <http://www.sec.gov/news/press/2006/2006-97.htm>.

³ Available at http://www.pcaobus.org/News_and_Events/Events/2006/Speech/11-17_Olson.aspx.

Virtually without exception, [CEOs of public companies] have remarked that the internal control framework has made their companies better organizations. But, virtually all also believe that the incremental cost to date has exceeded the incremental benefit. It soon became clear to the PCAOB that we had to build clearer guidance into AS2 regarding efficient, risk-based, and scalable implementation.

Speech to the Financial Executives International Shaping the Future of Financial Reporting Conference, New York, NY, November 17, 2006

“The Board’s goal has been to apply the feedback we’ve received and our observations of implementation to create an auditing standard that preserves the intended benefits without resulting in unnecessary effort and costs. We believe the new standard will result in audits that are more efficient, risk-based and scaled to the size and complexity of each company. We look forward to comments on the proposal.”

Public Company Accounting Oversight Board, “Board Proposes Revised Auditing Standard on Internal Control over Financial Reporting,” press release, December 19, 2006⁴

Auditor inspections

“PCAOB inspections are also risk-biased, in that they focus on the aspects of audits that present the greatest risk. When inspectors find an audit that is not satisfactory, they discuss with the firm precisely what the deficiency is. Often this dialogue leads to immediate corrective action.”

Testimony before the Committee on Financial Services, United States House of Representatives, September 19, 2006⁵

“Alerting auditors to practices and trends that may be relevant to their ongoing audits is a critical part of the PCAOB’s approach to oversight. The Board’s goal is to help auditors identify and address problems in financial reporting in order to protect investors’ interests in high-quality and reliable audits. The PCAOB’s work in the area of auditing employee stock option grants is an important step toward this goal.”

Testimony before the Committee on Banking, Housing, and Urban Affairs, United States Senate, September 6, 2006⁶

“For one thing, PCAOB inspections begin by looking at the professional environment in which audits are performed and focus on the influences – both good and bad – on a firm’s audit practice. These influences include a firm’s culture and the relationships between the firm’s audit practice and its other practices, as well as between engagement personnel in field or affiliate offices and a firm’s national office.”

Testimony before the Committee on Financial Services, United States House of Representatives, September 19, 2006

⁴ Available at http://pcaobus.org/News_and_Events/News/2006/12-19.aspx.

⁵ Available at http://www.pcaobus.org/News_and_Events/Events/2006/Testimony/09-19_Olson.aspx.

⁶ Available at http://www.pcaobus.org/News_and_Events/Events/2006/Testimony/09-06_Olson.aspx.



The PCAOB's relationship with the SEC

“Not only does the SEC oversee the work of the PCAOB, but the PCAOB and the SEC share an important responsibility for investor protection, and therefore naturally work closely together on achieving mutual mandates...”

Testimony before the Committee on Financial Services, United States House of Representatives, September 19, 2006

“It is important to stress that the PCAOB is not the authority on disclosure or GAAP issues in SEC filings – that is the purview of the SEC. However, our inspections must look at how and why the auditors made the calls they did on difficult accounting issues in client financials, which may lead to the identification of potential GAAP issues. In such circumstances, the inspectors will review the potential issues with the audit firm. If it appears to the PCAOB that financial statements may materially depart from GAAP, or were prepared by an auditor that was not independent, the PCAOB will describe that in the inspection report and inform the SEC.”

Speech to the Financial Executives International Shaping the Future of Financial Reporting Conference, New York, NY, November 17, 2006

The competitiveness of global capital markets

“Today, our markets are more global than ever, and financial systems are increasingly more sophisticated and accessible. Cross border transactions have been greatly facilitated in recent years due to the removal of a number of barriers and technological advancements. This has, in turn, facilitated greater access by investors and companies to cross border markets, thus enhancing their ability to seek greater returns and diversify their portfolios. This increase in global mobility of funds means that we all have a stake in promoting vibrant, transparent markets. Supervisors and regulators must keep pace.”

Speech at the Fédération des Experts Comptables Européens (FEE) Conference on Audit Regulation, Brussels, Belgium, October 12, 2006⁷

“To be sure, many markets outside of the United States have risen to become global players. As a result, companies today are presented with more options when they are determining where to raise capital, whether it be on a non-U.S. market or through private capital. The U.S. markets have never been the low cost alternative, however.”

Speech at the National Association of Corporate Directors Annual Corporate Governance Conference, Washington, DC, October 17, 2006⁸

⁷ Available at http://www.pcaobus.org/News_and_Events/Events/2006/Speech/10-12_Olson.aspx.

⁸ Available at http://www.pcaobus.org/News_and_Events/Events/2006/Speech/10-17_Olson.aspx.

“We should bear in mind all the factors that impact the competitiveness of the U.S. capital markets. Increasingly, many are viewing private litigation as the most significant force working against U.S. competitiveness. Also, a recent study conducted on behalf of the London Stock Exchange observed that relatively higher costs of issuing equity in the United States were mainly due to the systematically higher underwriting fees charged for U.S. transactions.”

Speech to the Financial Executives International Shaping the Future of Financial Reporting Conference, New York, NY, November 17, 2006

“To this end, a healthy degree of competition among our markets should be embraced. Companies today are presented with more options when they are determining where to raise capital. Regulatory regimes, as well as local political and cultural influences, are often factored into this decision. Competition can force efficiencies, yet we should be wary of competition that is based on cost alone. Having the right balance of oversight and regulation promotes innovation and protects the long-term reliability, stability and depth of capital markets, so they can continue to attract investors and issuers worldwide.”

Speech at the Fédération des Experts Comptables Européens (FEE) Conference on Audit Regulation, Brussels, Belgium, October 12, 2006

“I firmly believe that regulation, if balanced, attracts capital and builds confidence in markets. In fact, from the U.S. perspective, we have seen that listings on the U.S. markets have continued to command a valuation premium. Although some evidence seems to indicate that the cross-listing premium for foreign companies listing in the United States has declined post-Sarbanes-Oxley, there remains a substantial premium for cross-listing in the United States.”

Remarks at the AICPA National Conference on Current SEC and PCAOB Developments, December 11, 2006⁹

Extraterritoriality and the global reach of the PCAOB

“We at the PCAOB continue to be keenly aware of the potential for duplicative regulatory costs and the sensitivity to having PCAOB personnel inspect the files of non-U.S. firms.”

“Countries have taken a variety of approaches in implementing their auditor oversight models, due in part to differences in legal and cultural foundations. All, however, share the objective of improving the public confidence in the credibility of audits of financial statements.”

“Due to the increasingly global footprint of large audit firms and the increasing inter-relationships between capital markets, auditor oversight bodies must continue to find ways to enhance coordination of their work and exchange experiences. The PCAOB recognizes the importance of cross-border coordination and a global dialogue among auditor oversight bodies.”

⁹ Available at http://www.pcaobus.org/News_and_Events/Events/2006/Speech/12-11_Olson.aspx.

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“Public oversight of the audit profession remains a new development. I have stressed this morning the value that it brings in promoting confidence in our markets globally. Because of the global nature of the audit profession and the importance of our shared objective, allow me to reiterate how committed I personally am to furthering close and active working relationships with the PCAOB’s counterparts.”

Speech at the Fédération des Experts Comptables Européens (FEE) Conference on Audit Regulation, Brussels, Belgium, October 12, 2006

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Appendix 1: Board Proposes Revised Auditing Standard on Internal Control over Financial Reporting¹⁰

Washington, DC, December 19, 2006 – The Public Company Accounting Oversight Board today voted unanimously to propose for public comment a new standard on auditing internal control over financial reporting and other related proposals. The proposed standard would replace the Board’s existing internal control standard, Auditing Standard No. 2.

The proposed new standard on internal control is a principles-based standard designed to focus the auditor on the most important matters, increasing the likelihood that material weaknesses will be found before they cause material misstatement of the financial statements. The proposed standard also eliminates audit requirements that are unnecessary to achieve the intended benefits, provides direction on how to scale the audit for a smaller and less complex company, and simplifies and significantly shortens the text of the standard.

“Today’s proposal is the result of the PCAOB’s experience with the first two years of auditors’ implementation of the internal control provisions of the Sarbanes-Oxley Act,” said PCAOB Chairman Mark Olson. “The Board’s goal has been to apply the feedback we’ve received and our observations of implementation to create an auditing standard that preserves the intended benefits without resulting in unnecessary effort and costs. We believe the new standard will result in audits that are more efficient, risk-based and scaled to the size and complexity of each company. We look forward to comments on the proposal.”

In addition to the proposed internal control standard, the Board also proposed for public comment a new auditing standard on considering and using the work performed by internal auditors, management and others in an integrated audit of financial statements and internal control, or in an audit of financial statements only. This proposed standard is intended to further clarify how and to what extent an independent auditor may use that work to reduce the work the auditor otherwise would have to perform. In addition, the Board proposed to revise the independence requirement that currently is embedded in the text of AS No. 2, which requires the auditor to seek specific pre-approval by the audit committee of any internal control related service. Finally, the Board also proposed certain changes to its other standards to conform to the changes being brought about by this rulemaking.

“A principal focus in developing this proposal was to retain and strengthen the substantial benefits investors have received from improved internal control over financial reporting,” said Tom Ray, PCAOB Chief Auditor and Director of Professional Standards. “I believe we have proposed a standard that will achieve that objective while reducing audit effort, especially for smaller companies.”

The proposed standard and related documents are available on the Board’s Web site under Rulemaking Docket 21.¹¹

¹⁰ The text of the appendix is taken from Public Company Accounting Oversight Board, “Board Proposes Revised Auditing Standard on Internal Control over Financial Reporting,” press release, December 19, 2006, http://www.pcaobus.org/News_and_Events/News/2006/12-19.aspx.

The Board will seek comments on the proposed standard and other proposals for 70 days and will carefully consider all comments received. Comments will be posted on the Board's Web site under Rulemaking. Following the close of the comment period on February 26, 2007, the Board will determine whether to adopt a final standard. Any final standard adopted will be submitted to the Securities and Exchange Commission for approval.

A more detailed discussion of the matters proposed for public comment follows.

At today's meeting the Board also adopted a rule temporarily adjusting the minimum frequency with which the Board inspects registered public accounting firms that have 100 or fewer issuer audit clients. Public comment is also being sought on the question of whether to make this temporary adjustment permanent. Following the close of this comment period on February 16, 2007, the Board will determine whether to make this rule permanent. Any final rule adopted will be submitted to the Securities and Exchange Commission for approval. The Board also adopted technical amendments to correct non-substantive points in other Board inspections rules. The adopted rule and related documents are available on the Board's Web site under Rulemaking Docket 22.

Background

In June 2003, the Securities and Exchange Commission ("SEC") implemented Section 404 of the Sarbanes-Oxley Act of 2002 (the "Act") by adopting rules requiring issuers to include in their annual reports an assessment of the company's internal control over financial reporting as well as an auditor's report on that assessment. Soon after, as required by Sections 404(b) and 103 of the Act, the Board adopted Auditing Standard No. 2, *An Audit of Internal Control Over Financial Reporting Performed in Conjunction with an Audit of Financial Statements* ("AS No. 2"), to apply to the newly required audits. The SEC approved AS No. 2 on June 17, 2004.

Two annual financial reporting cycles have been completed since public company auditors began applying AS No. 2 to audits of the largest public companies. During this time, the PCAOB has closely monitored implementation of the standard and the progress auditors have made in complying with its requirements. The PCAOB's monitoring has included gathering information during inspections of registered public accounting firms; participating, along with the SEC, in two roundtable discussions with representatives of issuers, auditors, investor groups, and others; meeting with its Standing Advisory Group; receiving feedback from participants in the Board's Forums on Auditing on the Small Business Environment; and reviewing academic, government, and other reports and studies.

From all of these sources of information, two basic propositions have emerged. First, the audit of internal control over financial reporting has produced significant benefits. Issuers and auditors have described a focus on corporate governance that had not existed in the past and improvements in the quality and efficiency of important corporate processes and controls. Corporate board members have noted an improvement in audit

¹¹ The full text of the proposed rule changes is available at http://www.pcaobus.org/Rules/Docket_021/index.aspx.

committee oversight, while investors have found public company financial reporting to be of higher quality and enhanced transparency.

Second, these benefits have come with significant cost. Over the last two years, the Board has heard a consistent message that compliance with the internal control provisions of the Act has required greater effort and resulted in higher costs than expected. The Board agrees that auditors should perform internal control audits as efficiently as possible for companies that are required by the SEC's rules to obtain an audit report on internal control. With this in mind, the Board has evaluated every significant aspect of the audit of internal control to determine whether the existing standard encourages auditors to perform procedures that are not necessary in order to achieve the intended benefits. The proposals result from that evaluation.

Proposed Auditing Standard – An Audit of Internal Control Over Financial Reporting that is Integrated with an Audit of Financial Statements.

The proposed standard would supersede AS No. 2 and is designed to focus the auditor on the matters most important to internal control; eliminate unnecessary procedures; simplify and shorten the standard by reducing detail and specificity; and make the audit more scalable for smaller and less complex companies. Among other things, the proposed standard would:

- Direct the auditor to the most important controls and emphasize the importance of risk assessment;
- Revise the definitions of significant deficiency and material weakness, as well as the “strong indicators” of a material weakness;
- Clarify the role of materiality, including interim materiality, in the audit;
- Remove the requirement to evaluate management’s process;
- Permit consideration of knowledge obtained during previous audits;
- Direct the auditor to tailor the audit to reflect the attributes of smaller and less complex companies;
- Refocus the multi-location testing requirements on risk rather than coverage; and
- Recalibrate the walkthrough requirement.

The Board is also seeking comment on certain related proposals that would facilitate the Board’s efforts to make audits of internal control more effective and efficient. These related proposals are described below.

Proposed Auditing Standard – Considering and Using the Work of Others.

The proposed standard would supersede AU sec. 322 and the direction currently contained in AS No. 2 regarding using the work of others. Among other things, the proposed standard would:

- Allow the auditor to appropriately use the work of others, and not just internal auditors, for both the internal control audit and the financial statement audit, eliminating a barrier to integration of the two audits;
- Encourage greater use of the work of these others by requiring auditors to evaluate whether and how to use their work to reduce auditor testing;
- Require the auditor to understand the relevant activities of these others and determine how the results of that work may affect the audit;



- Provide a single framework for using the work of others based on the auditor’s evaluation of the combined competence and objectivity of others and the subject matter being tested; and
- Eliminate the explicit principal evidence provision previously included in AS No. 2.

Proposed Rule 3525 – *Audit Committee Pre-approval of Services Related to Internal Control*

The proposed new independence rule would replace direction currently contained in AS No. 2 regarding independence and internal control-related services. The proposed rule is intended to ensure that audit committees are provided relevant information for them to make an informed decision on how the performance of internal control-related services may affect independence. The new rule would also recognize that audit committees may pre-approve the provision by their independent auditor of internal control-related services on an ad hoc (i.e., specific to each request) basis, or pursuant to committee-approved policies and procedures.

Proposed Amendments to the Board’s Interim Standards

The Board is proposing amendments that, among other things, would:

- Simplify the internal control standard by moving certain information currently contained in AS No. 2 to other existing interim standards. For example, the proposed amendments would move the auditor’s responsibilities for management’s internal control certifications under Section 302 of the Act into AU sec. 722, Interim Financial Information; and
- Change the existing requirement that “generally, the date of completion of the field work should be used as the date of the independent auditor’s report” to “the auditor should date the audit report no earlier than the date on which the auditor has obtained sufficient competent evidence to support the auditor’s opinion.”