



1666 K Street, N.W.  
Washington, DC 20006  
Telephone: (202) 207-9100  
Facsimile: (202) 862-8430  
[www.pcaobus.org](http://www.pcaobus.org)

**STATEMENT OF KAYLA J. GILLAN**

**March 9, 2004**

***Adoption of Auditing Standard for Internal Control  
Over Financial Reporting***

Thank you, Mr. Chair, Messrs. Carmichael and Ray, and Ms. Phillips.

I am pleased to support the auditing standard before us today. I would like to address two of the themes that were addressed in the over 190 comment letters that we received.

First: costs. Let there be no mistake. Requiring auditors to audit a company's internal controls over financial reporting will require the auditor to do things – to evaluate systems and perform tests – which the auditor has not done before. This additional work will result in increased audit fees. These additional costs, when coupled with the resources which companies are having to directly dedicate to perform their own assessments of (and improvements in) internal controls, are not insignificant. However, we firmly believe that these costs are more than offset by the benefits that strong and effective internal controls provide to increase the reliability of financial reports. The providers of this capital – company owners – agree. The AFL-CIO, on behalf of union-sponsored pension plans holding almost \$400 billion in assets, told us:

The proposed standard strikes the right balance between the obligations placed on public companies and their auditors, and the needs of investors to have assurances that corporate internal controls are effective. As investors, we

believe that any additional costs that companies incur in meeting the proposed standard will be greatly outweighed by the savings shareholders will gain from more accurate financial statements.

The Ohio Retirement Systems, collectively managing over \$115 billion in assets, said:

Although this proposed rule may result in some increase in audit costs, the benefits will greatly outweigh the potential cost increase. Further, the PCAOB proposed rule will help restore investor confidence in the integrity of the financial statements of publicly traded companies.

Also in support were the State of Wisconsin Investment Board, with assets of over \$63 billion; the Council of Institutional Investors, whose members manage more than \$3 trillion; and the California Public Employees' Retirement System, with assets of over \$180 billion.

Many of the public companies who commented on the original proposal seemed to expect the auditor to use a minimalist approach to the new responsibilities mandated by Sarbanes-Oxley: they seemed to want a simple rubber stamp on management's own assessment of the effectiveness of these controls. This mentality epitomized, to me, the very attitude that resulted in many of the corporate scandals that are still shaking investor confidence. An audit is not a commodity purchased by management; it is an important safeguard and service that is principally designed for the protection of investors.

Before I leave the subject of costs, let me be clear about another point: the work that auditors must now perform with respect to internal controls is not an excuse to price gouge. I urge any company that believes its auditor is overcharging for this work to contact us.

My second point concerns the issue of how much of the actual testing must be performed by the auditor, him or herself, and how much the auditor may rely on the work of others (for example, the company's internal audit personnel). This is an area in which we have made the most changes from the original proposal. Our objectives in this area are two-fold: first, we did find compelling comments suggesting that more auditor discretion regarding reliance would be appropriate from a cost-benefit perspective. Second, we believe that internal audit programs that are both highly competent and independent from company management represent a valuable long-term tool for increasing financial reporting reliability. I hope, through the revisions in this area, that we encourage companies to strengthen their internal audit departments; if they do so, the auditor should be able to rely more readily and extensively on these internal experts, thus reducing the external auditor's fee.

Lastly, I would also like to acknowledge the incredible work of Doug Carmichael, Tom Ray and Laura Phillips. This is [as others have pointed out] the first substantive standard proposed and adopted by this Board. You have exhibited tremendous patience with our almost obsessive need to get this one right, and tolerance for the learning curve that I know I, as one board member, have been on. I can honestly say that I don't believe there are three other people on Earth who could have done what you have done, with the quality and thoroughness that you have done it. Thank you.