funds generally are trying to take on more risk to make up for the low-return environment, she said.

"There are so many wild cards out there," she continued. "You want to think we have learned lessons from Enron, but have we really? It doesn't sounds like it."

Compensation Consultants Continue to Play Role. While many want compensation committees to do more, some say they are doing just fine managing all of the new requirements of the last few years.

"Companies are so overwhelmed at this point, trying to deal with a panoply of new laws and regulations. They are doing the best they can to keep up with what is going on in a very fast-developing landscape," Thatcher said. Some of these new requirements include the Jan. 1, 2006, deadline for most companies complying with Financial Accounting Standard 123(R) on expensing of stock options, and new deferred compensation legislation under tax code section 409(a). She said this is "a really far reaching act that covers a lot of things people did not traditionally think of as deferred compensation," such as equity awards, separation pay, and severance pay.

"We will continue to see, in large part, that compensation consultants have more influence over where compensation goes than anyone else."

LAURA G. THATCHER
ALSTON & BIRD LLP

Thatcher, who serves as a director and compensation committee chair for Batson-Cook Co., said compensation committees that she deals with are taking their jobs seriously and trying to avoid liability by tripping over inadvertent violations of new laws and regulations, but are also giving new thought to redesigning their compensation programs and aligning compensation with performance.

Compensation committees "don't dream up these programs themselves; they hire consultants," she said. "We will continue to see, in large part, that compensation consultants have more influence over where compensation goes than anyone else."

She went on to say everyone "can overreact to all of this negative attention" and "there is a fine line in making appropriate adjustments without going too far." She said she has been encouraged by the messages that consulting firms are giving.

"National consulting firms have stepped up to the plate and taken some of the blame," she said. "Now, they are making a concerted effort to get the word out. A lot of consultants are speaking strongly about the need to come up with programs that compensate executives fairly but also focus on performance. They are really taking a good look at things that have become sacrosanct, like annual grants of equity awards, and thinking: what is their purpose? Should it be annual or just enough to get enough stock into the hands of management so they think like shareholders?"

Mentioning the executive compensation legislation introduced by Frank, she said, "Obviously, that will not sail through unopposed, but what is interesting to me is that Congress will not be shy about stepping in where the private sector fails to apply self-discipline." She went on to say, however, that "Congress is singularly ill-equipped to get into that."

BY ALISON CARPENTER

AFSCME's shareholder proposals for 2006 are available on its Web site at http://www.afscme.org/press/2005/pr051207.htm.

More information on ICCR's shareholder resolutions is available at http://www.iccr.org/.

ISS policy updates for 2006 are available for purchase on its Web site at http://www.issproxy.com/2006policy/index.jsp. The news release is on its Web site at http://www.issproxy.com/pressroom/index.jsp.

Auditor Oversight

PCAOB Leadership in Transition; Scope of Internal Control Audits Uncertain

The Public Company Accounting Oversight Board begins 2006 at a transition point, with an interim chairman and the imminent departure of its top auditing standard-setter. While the board that was created to oversee the accounting profession began 2005 with an aggressive standard-setting agenda, the PCAOB begins its third year on less certain ground.

In addition to choosing new leadership at both the PCAOB and some key posts at the Securities and Exchange Commission, SEC Chairman Christopher Cox has the task of deciding what to do about Sarbanes-Oxley Act Section 404 for smaller public companies.

Investor representatives are hopeful Cox will define himself by protecting investors, but the future is uncertain. "Thus far, I think Cox has been true to his word and the confirmation process, but nonetheless, he is confronted with a whole series of challenges that will force him to define himself," Damon Silvers, associate general counsel for the AFL-CIO, told BNA Jan. 6.

Top Pending Issues.
The PCAOB's top pending issues include:

- who will be appointed as a new PCAOB chairman,
- possible SEC action on SOX Section 404 and related changes to Auditing Standard No. 2 on audits of internal controls over financial reporting,
- standards on fraud detection by auditors,
- standards on communication between auditors and their clients,
- standards on quality control at audit firms, and
- final adoption of the proposed auditor independence rules on limiting tax services auditors can provide to audit clients.

"Christopher Cox is still an open question as SEC chair," Barbara Roper, director of investor protection for the Consumer Federation of America, said in a recent interview. "He has insisted he is not whom everybody thinks he is, and has made some early decisions that leave open the possibility that he won't be the consistent advocate of the business community that some people have predicted. We'll see. There's a lot that we don't know."

The appointment of a new chairman at the PCAOB, "more than any single issue, will determine the fate of lots of issues," she told BNA Jan. 3.

PCAOB Is in Transition. The transition last year began with changes at the SEC, when former SEC Chairman William Donaldson departed on June 30, and former California congressman Christopher Cox, a Republican, succeeded him as chairman on Aug. 4. On the heels of these changes, PCAOB Chairman William J. McDonough in September announced he would resign on Nov. 30 or whenever a successor took his place, whichever was sooner. When McDonough left the board in November, the SEC Dec. 2 selected PCAOB member Bill Gradison, also a former congressman, to act as interim chairman.

Two weeks later, the PCAOB announced that another key figure at the PCAOB, Chief Auditor Douglas Carmichael, would leave in February for personal reasons, and Thomas Ray, Carmichael's second-in-command as deputy chief auditor, would succeed him. The chief auditor at the PCAOB heads up the board's auditing standard-setting efforts. Ray's past positions include being a partner at the Big Four accounting firm KPMG LLP in New York, and serving as director of audit and attest standards at the American Institute of Certified Public Accountants.

In addition, the status of PCAOB member Kayla J. Gillan, whose term expired in October last year, is unclear. On Dec. 2, along with announcing the selection of Bill Gradison as acting chairman, the SEC announced new procedures for selecting the PCAOB's permanent chairman and board members that include background checks and interviews.

Roper told BNA one of the big issues for 2006 "is just the very practical issue of who is going to lead the PCAOB as a replacement for McDonough, and whether [current board member Kayla Gillan] will retain her seat."

She went on to say, "We are talking about the potential for significant new direction at the PCAOB, particularly with the appointment of a new chairman."

Section 404 Compliance Uncertain for Small Companies. The biggest uncertainty and controversy that could affect the PCAOB's work surrounds Section 404 of the 2002 Sarbanes-Oxley Act and the key audit standard drafted by the PCAOB and approved by the SEC in 2004—Auditing Standard No. 2 on internal controls over financial reporting (AS 2). Section 404 of the Sarbanes-Oxley Act requires corporate managers to assess and report on their companies' internal control systems over financial reporting and disclose any "material weaknesses" they find. Auditors of public companies must review and attest to the effectiveness of managers' reviews of their controls, as well as test key controls themselves. AS 2 gives auditors direction on how they should do this.

While companies that are accelerated filers started implementing Section 404 internal control reviews in their annual reports filed for their first fiscal years ending on or after Nov. 15, 2004, the SEC extended the Section 404 compliance deadline to mid-2007 for businesses with market capitalizations of up to $75 million. The PCAOB in 2005 not only issued two staff questions-and-answers to supplement the three sets of Q&A released in 2004, but the PCAOB and SEC May 16 each released guidance to help both auditors and their public company clients with Section 404 implementation.

Former SEC Chairman William Donaldson formed an advisory committee on smaller public companies in late 2004, in part to respond to concerns raised by U.S. companies that the costs for complying with SOX are excessive for many smaller public companies in particular, and are not tailored to their businesses.

Members of this committee, known as the SEC's Advisory Committee on Smaller Public Companies, Dec. 14 agreed to recommendations that extend beyond SOX to the application of federal securities laws and regulations more generally to smaller public companies.

In particular, they agreed the SEC should help smaller companies by exempting some from Section 404 rules on internal controls over financial reporting, subject to certain conditions, or at least change its rule on Section 404 implementation to a cost-effective standard. They also recommended that the SEC ask for additional guidance from the PCAOB for greater clarity and to encourage greater cost-effectiveness in the application of AS 2.

The SEC's advisory committee is scheduled to meet Jan. 23 to vote on a draft of recommendations that will go out for public comment.

Some leading investor representatives so far are concerned that the preliminary recommendations from the advisory committee would amount to a roll-back of key provisions of SOX. Both representatives of public companies and the investor community will be carefully monitoring the advisory committee's deliberations and the SEC's response to the group's recommendations as the commission strives to hit the right balance between costs of SOX compliance to companies and investor protection. Tweaking, rewriting, or even throwing out parts of the PCAOB's Auditing Standard No. 2 are all theoretical possibilities the SEC might have to consider if it acts on the advisory group's recommendations.

Cox Leadership Uncertain, Critical. Saying the SEC advisory committee "has done the commission no favors," Silvers said Cox is faced with a difficult challenge and his leadership is going to be critical.

"Investors will be looking to him to define himself on these issues," Silvers said.

Silvers said when one puts the recommendations of the SEC advisory committee together "with PCAOB appointments that are open, and the reality of the continuing litigation around mutual fund traders, Cox is faced with a bunch of serious challenges that will test him."

Other PCAOB Actions. In other action, the PCAOB in 2005 released its highly anticipated 2004 inspection reports on the audits of the Big Four accounting firms as well as other firms. The PCAOB in these reports said it found "audit deficiencies" in the work of all Big Four accounting firms, as well as other mid-level firms, in their audits of public companies' 2003 financial statements.

A major work area for the PCAOB in 2006 will be continuing to iron out any kinks in its inspection program so that the board's efforts continue to contribute to the overall goal of improving audit quality and ulti-

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mately the quality of public companies' financial statements. So far, only one round of full inspection reports for the Big Four firms has been released—the 2004 inspection reports. The 2005 inspections took place, but the PCAOB has not yet released any reports on those inspections.

The PCAOB did release a report Nov. 30 offering guidance on issues it has found in internal control audits, and Carmichael said in a BNA interview in November the PCAOB will issue a similar report that offers guidance on the implementation of Statement on Auditing Standards (SAS) 99, Consideration of Fraud in a Financial Statement Audit. The PCAOB's advisory group has indicated that an audit standard on fraud detection should be the board's primary focus.

Other Standard-Setting Efforts Ahead. At the PCAOB's advisory group meeting Oct. 5 and 6, Carmichael said another standard-setting priority for the PCAOB continues to be reviewing its interim standards to see if existing communication requirements between auditors and their audit clients should be changed.

Carmichael also said the PCAOB is considering a separate standard-setting project on the individual elements of quality control at audit firms, in particular, auditor independence quality controls. Part of the quality control discussion involved the issue of auditors that seek to limit liability through clauses in their audit engagement letters with clients, which many advisory group members said would not be a good idea.

Cynthia Richson, a member of the PCAOB's advisory group and corporate governance officer for the Ohio Public Employees Retirement System, told BNA the issue of auditors pushing for limited liability provisions will be critical and expressed the view that limiting auditor liability would undermine accountability. "If you give artificial tort reform to accountants, there is no way to hold people accountable. You are giving up a fundamental right that is part of our system," she said.

On the other side of the issue, some commentators in the press have said the specter of broad liability is a pressure too great for accounting firms to bear, especially with an audit services market for public companies that is basically an oligopoly dominated by the Big Four accounting firms.

Another key issue still to be resolved is further refinements to auditor independence rules. The PCAOB in July approved final rules concerning independence, tax services and contingent fees, and made technical amendments to them in November, but they are still held up at the SEC and cannot take effect until the SEC gives final approval.

By Alison Carpenter