

July 12, 2004

The Honorable William H. Donaldson
Chairman
Securities and Exchange Commission
450 5th Street, NW
Washington, DC 20549

Dear Chairman Donaldson:

It is with great pleasure that I deliver to you a summary of the Public Company Accounting Oversight Board's first performance review, conducted by the Board's Office of Internal Oversight and Performance Assurance. The Board formed IOPA to provide the Board, the Securities and Exchange Commission, and others, assurance that the PCAOB is achieving the objectives of Title I of the Sarbanes-Oxley Act in an effective manner. Like a federal Inspector General, IOPA conducts its performance reviews pursuant to the U.S. General Accounting Office's *Yellow Book* standards.

IOPA's first performance review examined the Board's system for processing and reviewing applications of public accounting firms for registration pursuant to Section 102 of the Act, and the Board's rules thereunder. Since October 22, 2003, it has been illegal for any U.S. public accounting firm to prepare, issue, or play a substantial role in the preparation or issuance of, an audit report on the financial statements of a U.S. public company unless it is registered. In its review, IOPA examined a statistical sample of those firms registered with the Board as of March 1, 2004. The sample covered the audit firms responsible for the audits of 78 percent of all issuers listed by registered firms as of March 1, 2004. IOPA also conducted interviews with key PCAOB officials involved in the registration process. The review provided the Board valuable assurance that its overall system of processing, reviewing and considering registration applications is consistent with Title I of the Act and promotes the interests of the investing public.

Although a registration system could lend itself to the most bureaucratic of processes, the Board chose to fashion a dynamic, relational registration database under an aggressive technology development schedule. Given the limited time to register firms by October 22, the conservative approach would have been to require each firm to submit a paper form containing the required registration information. Using a paper system, we certainly would have been able to complete the registration process by our deadline of October 22, but we would have lost a significant opportunity to capture the data that applicants submitted in a form that could be used for complex, relational risk

PCAOB

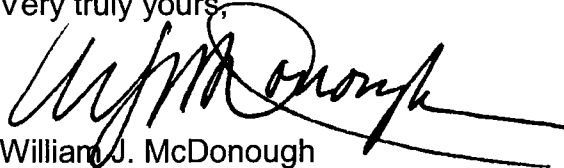
Public Company Accounting Oversight Board

analysis. Accordingly, the Board directed our Office of Information Technology to build the system from the ground up on a Web-based platform, where possible integrating and enhancing commercial, off-the-shelf, software components into an efficient and effective overall solution. I am pleased to report that our system has worked well throughout the last year, during which we have processed and considered more than 1,000 applications, each within the time period required by the Act and the Board's rules.

IOPA's review also made several constructive observations for the Board's consideration as we seek, over time, to maximize the benefits of our investment in the Web-based registration system and in other information technology. For example, as IOPA observed, we are establishing protocols for software application make/buy decisions that will help ensure that the PCAOB builds dynamic and cost-effective IT systems for our programs. In addition, the Board is seeking input from the broadest possible representation of our program and operations staff to assist in considering how best to use registration information and other data we collect. We also intend to use our Office of Information Technology to facilitate and support collaboration among the Board's programs and operations, to apply database technology and pattern-matching and other risk analysis techniques to uncover trends and subtle relationships in data collected through registration and other sources.

The Board intends to publish the attached summary of IOPA's review on our Website on Monday, July 19. You and your staff should feel free to contact the Director of IOPA, Peter Schleck (202-207-9115), if you have any questions or would like any additional information about this performance review.

Very truly yours,

A handwritten signature in black ink, appearing to read 'W. J. McDonough', written over a horizontal line.

William J. McDonough
Chairman

Attachment

PERFORMANCE REVIEW

THE PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD'S REGISTRATION PROCESS

JULY 19, 2004, INTERNAL OVERSIGHT AND PERFORMANCE ASSURANCE

Background and Objective

Section 102 of the Sarbanes-Oxley Act of 2002 requires accounting firms that prepare, issue, or participate in audits of U.S. public companies to be registered by the Public Company Accounting Oversight Board ("PCAOB" or the "Board") and specifies certain information the firms must provide. The registration process is further defined in PCAOB Rule 2106, which establishes that the Board will determine whether approval of an application for registration is consistent with the Board's responsibilities under the Act to protect the interests of investors and to further the public interest in the preparation of informative, accurate, and independent audit reports.

PCAOB records indicated that, as of March 1, 2004, 771 accounting firms had completed the online registration process established by the Board. At the request of the Board, the Office of Internal Oversight and Performance Assurance initiated this review^{1/} to assess the efficiency and effectiveness of the registration process.

Results of Review

Based on a review of the registration applications and related documentation for the eight largest U.S. accounting firms, and a statistical sample of all other firms registered with the PCAOB as of March 1, 2004, Internal Oversight and Performance Assurance concluded that –

^{1/} This is a public summary of the report. The full report, prepared in accordance with Government Auditing Standards, has been issued to the Board.

PERFORMANCE REVIEW

- material issues reported by registrants, as well as other issues that came to the attention of Registration and Inspections staff, were consistently researched, analyzed, and presented to the Board for consideration within established timeframes;
- Registration and Inspections staff routinely documented independent research or validation regarding application attributes, including legal proceedings, disagreements with clients, and firm licenses; and,
- application review processes established by Registration and Inspections staff to implement registration requirements of Sarbanes-Oxley and the related PCAOB rule were routinely followed and documented for each of the sample items we reviewed.

As a whole, the files we reviewed evidenced thorough review, frequent staff interactions with applicants, and extensive independent research and substantive analysis by senior Registration officials regarding such matters as legal proceedings, client disagreements, unfavorable peer reviews, unusually high ratios of audited issuers to accountants, and other issues that came to the attention of PCAOB staff. Based on separate tests focused on the largest firms, we also concluded that Board-determined registration fees were collected and accounted for in PCAOB financial records.^{2/}

In early 2003, after considering alternative approaches for registering accounting firms in accordance with Sarbanes-Oxley, the Board decided to develop its own Web-based registration system using PCAOB staff, consultants, and contract support. Key considerations in this decision included cost, confidentiality, and ownership. The review did not include a detailed technical analysis of the PCAOB's Web-based registration system.^{3/} However, for purposes of the review, Internal Oversight and Performance Assurance obtained access to the system sufficient to determine that, for the sample firms selected, application information was present and consistent with other information in the application files.

^{2/} A discussion of sample selection, review methodology, and results is included in the full report.

^{3/} PCAOB records indicate that it spent approximately \$3.6 million developing its Web-based system. Internal Oversight and Performance Assurance did not independently validate this amount.

PERFORMANCE REVIEW

Based on a limited review of high-level system documentation and discussions with Information Technology officials, we also included observations the Board may wish to consider as it seeks, over time, to maximize its investment in related information technology. For example, we discussed the potential benefits of, and staff has drafted, a protocol by which future software application make/buy decisions could be guided. We also suggested that continuing deliberations on how best to use registration data should include the broadest possible representation from each of the PCAOB's programmatic areas and the Information Technology staff.