

November 4, 2005

By Hand Delivery

The Honorable Christopher Cox  
Chairman  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549

Dear Chairman Cox:

I am pleased to transmit to you a summary of the Public Company Accounting Oversight Board's most recent 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 of 2002 in an effective manner. This is the fourth IOPA report that we have provided to the Commission.

This performance review focuses on the operations of the Board's finance office. The review is one in a series that IOPA, at the Board's direction, is conducting to assess the progress of key PCAOB programs and functions in establishing effective and appropriate internal controls.

Based on its review, IOPA concluded that, overall, controls generally worked as described and transactions were accurately recorded. The report also noted that the PCAOB's Chief Financial Officer and staff had facilitated the development and implementation of a number of important policies, processes, and other financial-related controls. IOPA also noted opportunities to strengthen financial controls at the PCAOB by completing a number of planned initiatives. In this regard, I am pleased to inform you of three finance-related initiatives.

First, a project is underway to develop certain progress and trend reports to assist in managing expenditures, recruiting, and IT investment. These reports may become useful tools to enhance the efficient use of PCAOB financial resources.

Second, we have enhanced our use of budgeting software tools in order to develop a budget for fiscal year 2006. The Board will consider its 2006 budget in the coming weeks and, as required by Section 109 of the Sarbanes-Oxley Act, will shortly thereafter submit it to the Commission for approval.

The Honorable Christopher Cox  
November 4, 2005  
Page 2 of 2

Finally, the first phase of the registration program – initial registration of public accounting firms that audit U.S. public companies – is likely coming to a close. One thousand five hundred thirty-four (1,534) firms have registered, and consistent with Section 102(f) of the Act, each such firm has paid a registration fee according to the schedule established by the Board in July 2003. We have already undertaken a review of the Board's schedule of registration fees to determine if such fees should be modified. In addition, we are developing an analysis to support a schedule of annual reporting fees, to be implemented in connection with the Board's establishment of a system of annual reporting by registered firms, as required by Section 102 of the Sarbanes-Oxley Act.

The Board intends to publish the attached summary of IOPA's review on the PCAOB's Web site on November 9, 2005. 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,



William J. McDonough  
Chairman

Enc.

cc. Mr. Donald T. Nicolaisen

---

---

## **PERFORMANCE REVIEW**

### **INTERNAL CONTROL REVIEW OF THE PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD'S FINANCE FUNCTION (IOPA-2005-002)**

**OCTOBER 27, 2005, INTERNAL OVERSIGHT AND PERFORMANCE ASSURANCE**

---

---

#### **Background and Objective**

In 2004, Internal Oversight and Performance Assurance completed an initial risk assessment of the Public Company Accounting Oversight Board's ("PCAOB" or the "Board") key programs and functions. Based on that assessment, we designed, and the Board directed us to complete, a series of performance reviews to be conducted during 2004 and 2005. The objective of these reviews is to assess the progress of key PCAOB programs and functions in establishing effective and appropriate internal controls over operations. As part of each review, Internal Oversight and Performance Assurance will identify and report on the current status of internal controls and any plans to add to, enhance, or benchmark those controls against existing standards. This report<sup>1</sup> focuses on the PCAOB's finance office.

Certain provisions of the Sarbanes-Oxley Act of 2002 help to convey the conceptual design of the PCAOB as a unique organization that pursues a public interest mission while maintaining the characteristics of a private sector entity. Specifically, Title 1 of the Act established the Board and specified that the PCAOB is not an agency or establishment of the U.S. Government, but that it operates as a non-profit corporation. Other provisions within this title require the Board to establish an annual budget; authorize the allocation, assessment, and collection of accounting support fees from

---

<sup>1/</sup> This is a public summary of the report. The full report, prepared in accordance with Government Auditing Standards, has been issued to the Board. The full report includes a detailed discussion of the review objective, scope, and methodology.

## **PERFORMANCE REVIEW**

public companies for recoverable expenses; and, authorize the assessment and collection of registration fees from registered public accounting firms to recover the costs of reviewing and processing registration applications. The Board's budget is subject to approval by the Securities and Exchange Commission ("SEC"). Additionally, the Board is required to submit to the SEC an annual report that includes audited financial statements.

The statutory provisions allowing the Board to assess and collect fees sufficient to fund its operations represent a significant authority. In providing this funding mechanism, the Act helps to ensure that the PCAOB has the resources to carry out its mission to protect investors and further the public interest. At the same time, however, by requiring that the PCAOB's budget be approved by a federal agency and that the Board publish audited financial statements, the statute mandates public accountability for those resources. Moreover, both the Board and the SEC have held open meetings on PCAOB budgets.

The explicit provisions regarding the PCAOB's funding and financial accountability, coupled with the Act's broader corporate governance objectives that the Board was created to help achieve, strongly suggest, in our judgment, that adoption of sound and effective financial internal controls is critical to the Board's credibility and success. In this regard, the continuing establishment of internal policies, procedures, and professional practices can help communicate to the accounting profession and the public that the Board sets high standards for its own operations.

For purposes of this review, we generally use the term "internal control" as defined by the Committee of Sponsoring Organizations ("COSO") of the Treadway Commission, reproduced below.

Internal control is broadly defined as a process, effected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- Effectiveness and efficiency of operations.
- Reliability of financial reporting.
- Compliance with applicable laws and regulations.

## **PERFORMANCE REVIEW**

While the COSO definition includes internal control relevant to financial reporting, it is important to note that COSO-defined controls also encompass business operations and the legal and regulatory framework in which an entity operates. Our review included all of these aspects of internal control, but it was not designed to allow us to express an opinion on internal controls over financial reporting in accordance with PCAOB Auditing Standard No. 2.

The mission of the PCAOB's finance office is to manage and report on the Board's financial resources. The office is led by the Chief Financial Officer ("CFO") who reports to the Chief Administrative Officer. The CFO is specifically responsible for budgeting, accounting, billing and collections, accounts payable, payroll, financial reporting, and the PCAOB's travel office. The CFO is also charged with establishing and documenting effective internal control with respect to financial reporting. As of April 2005, the finance office was staffed with eight regular employees, including, in addition to the CFO, a controller, a senior accountant, two accounts payable specialists, a travel manager, and an accounting clerk.<sup>2/</sup> In addition, the finance office budgeted \$369,000 for contractor-provided accounting support for 2005.

### **Results of Review**

Our review of the PCAOB's finance office included an analysis of each of the CFO's primary areas of responsibility: budgeting, financial reporting, accounts receivable, accounts payable, payroll, travel and expense reimbursement, and fixed assets. For each of these areas, we reviewed established policies, procedures, and controls, and interviewed responsible finance office personnel. For selected areas, we also tested related internal controls based on statistically-determined samples of transactions.

Based on our detailed tests of specific transactions and processes, we concluded that, overall, controls generally worked as described and transactions were accurately recorded. We also noted that the CFO and staff have facilitated the development and implementation of a number of important policies, processes, and other financial-related controls. Key among these accomplishments are the establishment and administration of the PCAOB's policy on expense reimbursement; a budgeting process that requires each PCAOB director to tie requested resources to the achievement of the Board's

---

<sup>2/</sup> Subsequent to the completion of our field work, the finance staff also added an Assistant Controller and a Senior Accountant Manager.

## **PERFORMANCE REVIEW**

strategic objectives; and, the production of financial statements that have, for the first two years of operations, resulted in unqualified audit opinions. In addition, the CFO noted that significant progress had been made in documenting internal control over financial reporting to a level sufficient to be examined by the PCAOB's external auditor; and, that the finance office had successfully developed and maintained a payroll system that has functioned effectively as the organization has rapidly grown from a start-up to its current size.

Opportunities also existed, however, for the finance staff to strengthen financial controls at the PCAOB by completing a number of planned initiatives. For example:

- Although the CFO had documented many controls and had initiated an effort to comprehensively document internal control over financial reporting using specialized software, the appropriate standard for internal control had not yet been determined. Options may include the process described in Section 404 of the Sarbanes-Oxley Act as implemented by SEC rule; the Federal Office of Management and Budget's Circular A-123; a PCAOB-specific standard that appropriately scales existing guidance to the organization; or, some other formulation.
- The CFO indicated that a project is underway to develop a series of reports that could provide key data to managers on a consistent and periodic basis, but the nature, content, timing, and distribution of such reports had not yet been fully determined.
- Planned improvements to the PCAOB's budgeting process needed to be presented to senior leadership for consideration.
- Additional analysis was needed to determine the total amount of costs associated with "processing and reviewing" accounting firm registration applications, to date, in order to compare it to the estimates used by the Board in setting the initial registration fees in July 2003.

Prompt completion of these initiatives will help to strengthen financial management practices at the PCAOB and help to ensure that the resources provided through fees levied on public companies and public accounting firms are used efficiently and effectively. Strong financial management is also important as the PCAOB's start-up

## **PERFORMANCE REVIEW**

phase ends and the organization seeks to continue to build credibility with investors, the accounting industry it regulates, and oversight entities.

The Chief Administrative Officer and the CFO jointly responded to a draft of this report by memorandum dated August 11, 2005. Management summarized its comments by stating that –

1. A project is underway to develop certain progress and trend reports for use by the Office of Administration in managing expenditures, recruiting, and IT investment. These reports may become useful tools to enhance the efficient use of PCAOB financial resources.
2. The CFO has enhanced the Office of Finance's use of budgeting software tools in order to develop, under the leadership of the Chief Executive Officer ("CEO" or the Chairman), a budget for fiscal year 2006.
3. The first phase of the registration program – initial registration of public accounting firms that audit U.S. public companies – is likely coming to a close. As of the third quarter of 2005, one thousand five hundred thirty-four (1,534) firms have registered, and consistent with Section 102(f) of the Act, each such firm has paid a registration fee according to the schedule established by the Board in July 2003. At this time, under the direction of the CEO, the Division of Registration and Inspections, the Office of Finance, and the Office of Information Technology, have undertaken a review of the Board's schedule of registration fees to determine if such fees should be modified in the future. In addition, these offices are developing an analysis to support a proposal for a schedule of annual reporting fees, to be implemented in connection with the Board's establishment of a system of annual reporting by registered firms, in the future.

Regarding the CFO's project to fully document internal control over financial reporting, management's response also stated that the Office of Finance has planned and will begin a self-assessment test in August 2005.