

PCAOB

Public Company Accounting Oversight Board

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REQUEST OF THE PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

FOR

**COMMISSION DETERMINATION PURSUANT TO SECTION 101(D) OF THE
SARBANES-OXLEY ACT OF 2002***

Submitted to the

SECURITIES AND EXCHANGE COMMISSION
450 Fifth Street, N.W.
Washington, D.C. 20549

on

April 25, 2003

* This booklet also contains the Board's release adopting rules on public accounting firm registration: Registration System for Public Accounting Firms, PCAOB Release No. 2003-007 (May 6, 2003).

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April 25, 2003

BY MESSENGER

The Honorable William H. Donaldson
Chairman
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Re: Request of the Public Company Accounting Oversight Board for Commission Determination Pursuant to Section 101(d) of the Sarbanes-Oxley Act of 2002

Dear Chairman Donaldson:

The Public Company Accounting Oversight Board ("Board") is pleased to request that the Securities and Exchange Commission ("Commission") determine, in accordance with Section 101(d) of the Sarbanes-Oxley Act of 2002 ("Act"), that the Board is "organized and has the capacity to carry out the requirements of this title [I of the Act], and to enforce compliance with this title by registered public accounting firms and associated persons thereof." As described in this letter and in the accompanying materials, the Board believes that it has more than fully met the statutory prerequisites for this determination.

OVERVIEW

Section 101(a) of the Act establishes the Board to oversee the audits of public companies that are subject to the federal securities laws and to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports for companies the securities of which are sold to, and held by and for, public investors. All of the members of the Board take extremely seriously the important responsibilities that the Act imposes on the Board and are committed to structuring the Board in a manner that will fulfill those responsibilities and restore public confidence in the auditing profession.

The Commission appointed the five initial members of the Board on October 25, 2002. One member resigned on November 13. During November and December, the Board met informally on several occasions and devoted considerable effort to obtaining

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office space for the Board, beginning the recruitment of senior staff, and taking other steps to put in place the infrastructure necessary to begin operations. The Board also catalogued the issues it would be required to address during the coming months and began planning how to resolve those issues. During this period, Board members also dealt with the termination of their prior employment responsibilities, and with other personal obligations, in order that they could commence fulltime Board service. The Commission's staff undertook appointee background investigations, which were apparently completed satisfactorily in late December.

The Board members assumed their positions on January 1, 2003. Over the week-end of January 4, the Board took occupancy of its offices at 1666 K Street, in Washington, DC. On January 9, the Board held its first official, public meeting.

Since January 1, the Board has concentrated its efforts on six key tasks –

- Creating an organizational structure and hiring senior staff. Much of the Board's effort has been devoted to creating an organizational structure and hiring senior staff members in a manner that will foster our long-term success. One of the Board's objectives in this regard is to foster a working environment marked by enthusiasm for the Board's mission and commitment to integrity. While the staffing effort is still underway, most of the top positions – including General Counsel, Chief Auditor, Chief Administrative Officer, Director of Registration and Inspections, Director of Public Affairs, Director of Human Resources, and Chief Technology Officer – have been filled, either on a permanent or acting basis. In addition, the Board has, under favorable lease terms, secured office space in Washington, D.C. and New York adequate to meet the anticipated growth of the organization for several years.
- Developing a public accounting firm registration system. The registration of public accounting firms is the predicate for Board jurisdiction over such firms, and the Act requires that all firms engaged in public company auditing register by October 26, 2003. Accordingly, one of the Board's top priorities has been creating the legal and technology framework for its registration system. In addition, the Board has determined, after carefully considering a variety of views, that foreign accounting firms that audit U.S.

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public companies should, like domestic firms, be required to register with the Board.

- Creating an inspection program. The Board believes that a vigorous inspection program, staffed by experienced Board employees, is essential to assuring the public of the quality of audits. The Board has announced that, while its inspection program may not be fully operational until 2004, it will begin inspections of the four largest accounting firms during 2003. Accordingly, the staffing and organization of the inspection function, including the establishment of a field office in New York, have been a top priority.
- Reviewing professional standards and establishing a new standards-setting process. The Act directs the Board to establish auditing, attestation, quality control, ethics, and independence standards applicable to accountants in the preparation and issuance of audit reports with respect to public companies. This is obviously an extremely complex task, with far-reaching implications for auditors, public companies, and users of audited financial statements. The Board has therefore devoted considerable time and attention to defining the process by which it will develop new professional standards. In addition, the Board intends to conduct a systematic review of existing standards and, where appropriate, to make revisions. The Board believes that it should encourage broad participation in its standards-setting and recognizes that the assistance of both Board staff and outside experts will be necessary.
- Establishing a budget, and a self-funding program. While the operations of the Board will require significant resources, Congress directed the Board to implement a funding plan that relies primarily on public companies and that does not make use of taxpayer monies. Budgeting, and the design and implementation of the private funding system, are therefore essential to the Board's success.
- Reaching out to market participants. Because it was recently created and has been operating in a start-up phase, there is considerable uncertainty among issuers, investors, and the auditing community concerning the objectives and responsibilities of the Board. Accordingly, Board members

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have sought, to the greatest extent possible consistent with their other duties, to make themselves available as speakers and program participants in a variety of fora in order to communicate with the public and other constituencies concerning the Board's mission.

DISCUSSION

The following is a summary of the major actions taken by the Board. The documents that reflect these actions are enclosed as exhibits to this letter.

1. Board Administration

a. Bylaws

Section 101(b) of the Act provides that the Board is a private, Congressionally-created body with the powers of a District of Columbia nonprofit corporation. The Act contemplates that the Board, like other private corporations, will adopt bylaws governing matters of governance and decision-making process. Accordingly, on January 9, 2003, at its first public meeting, the Board adopted bylaws. On April 25, 2003, the Board amended Article VI of the bylaws to provide for the powers of a Chair/Chief Executive Officer. The bylaws, as amended, are subject to approval by the Commission pursuant to Section 107 of the Act. See Exhibits 1-A and 1-B.

b. Ethics Code

Section 101(g)(3) of the Act requires the Board to establish ethics rules and standards of conduct for Board members and staff. At its public meeting on April 16, 2003, the Board proposed for public comment an Ethics Code. See Exhibit 1-C. The comment period on this proposal will expire on May 9, 2003. Following the close of the comment period, the Board will review the comments received, adopt a final Ethics Code, and submit the Code to the Commission for approval pursuant to Section 107 of the Act.

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c. Budget

Section 109(b) of the Act requires the Board to prepare and submit to the Commission for approval a budget for the Board's first fiscal year. At its first public meeting on January 9, 2003, the Board approved and submitted to the Commission a cash flow-based funding request to permit the Board to accomplish the organizational tasks contemplated by the Act. This initial request was subsequently supplemented on March 7, 2003. At its public meeting on April 23, 2003, the Board approved a budget for the 2003 fiscal year. The budget was transmitted to the Commission for approval on April 24, 2003. See Exhibit 1-D.

d. Personnel

Section 101(f)(4) of the Act authorizes the Board to hire employees, and to determine their qualifications, define their duties, and fix their salaries or other compensation at a level that is comparable to that paid by private sector self-regulatory, accounting, and similar organizations. Soon after the Board members were appointed, we recognized that this function could not be deferred; indeed, we would not have been able to begin functioning on January 1 without a core group of employees. Accordingly, we retained both benefits and executive search consultants, and obtained the salary data from the National Association of Securities Dealers and the Financial Accounting Standards Board in order to aid us in establishing general salary and benefit parameters consistent with Section 101(f)(4).

The Board has been engaged in an aggressive program of recruitment and interviewing to fill the senior Board staff positions. The Board's Office of Human Resources has prepared a paper summarizing accomplishments in this area. See Exhibit 1-E.

2. Professional Auditing Standards

a. Interim Standards

Section 103(a)(3)(B) of the Act requires the Board to adopt professional standards as initial or transitional standards, to the extent the Board determines necessary, prior to the Commission's determination under Section 101(d) that the Board is capable of carrying out its responsibilities under the Act. These initial or transitional

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standards must be separately approved by the Commission at the time of that determination without regard to the procedures otherwise applicable to Board rules under Section 107.

At its public meeting on April 16, 2003, the Board approved the issuance of PCAOB Release No. 2003-006. See Exhibit 2-A. This release announces the adoption of certain interim auditing, attestation, quality control, ethics, and independence standards to be used by registered public accounting firms in the preparation and issuance of audit reports. Rules 3200T, 3300T, 3400T, 3500T, and 3600T, which were adopted by the Board in Release No. 2003-006, require registered public accounting firms to follow these interim standards. The Board has not determined that any of these standards should be permanently adopted, and the letter "T" has been appended to the rules implementing the transitional standards to emphasize the fact that the standards are temporary. Release No. 2003-006 also announced that the Board plans to systematically review all of the interim professional standards and to determine whether each of the interim standards should be modified, repealed, or made permanent.

b. Standard Setting Process

Section 103(a)(1) of the Act directs the Board, by rulemaking, to establish auditing, attestation, quality control, and ethics standards to be used by registered public accounting firms in the preparation and issuance of audit reports. The Act provides that, to the extent it determines appropriate, the Board may adopt standards proposed by designated professional groups of accountants or Board advisory groups, but affords the Board considerable discretion as to the procedures to be employed in developing professional standards.

At its public meeting on April 16, 2003, the Board approved the issuance of PCAOB Release No. 2003-005. See Exhibit 2-B. This release announces the general process by which it will establish permanent auditing and other professional standards for registered public accounting firms. This process will include the appointment of an advisory group, as envisioned by Section 101(a)(4), and the Board proposed for public comment Rule 3700, which would describe the composition of this advisory group. The Board also proposed for public comment Rule 3100 (and a related definition), which would require registered public accounting firms to adhere to the Board's professional standards. The comment period on the rules proposed in Release No. 2003-005 will

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expire on May 12, 2003. Following the close of the comment period, the Board will review the comments received, adopt final rules, and submit those rules to the Commission for approval pursuant to Section 107 of the Act.

3. Registration

Section 102(a) of the Act provides that, beginning 180 days after the Commission's Section 101(d) determination that the Board has the capacity to carry out its responsibilities, it will be unlawful for any person that is not a registered public accounting firm to prepare, issue, or participate in the preparation or issuance of any audit report with respect to a U.S. issuer. Section 106(a) of the Act provides that any foreign public accounting firm that prepares or furnishes an audit report with respect to any U.S. issuer is subject to the Board's rules to the same extent as a U.S. public accounting firm. Section 106(a) further authorizes the Board to determine that foreign public accounting firms that do not issue such audit reports, but that play a substantial role in the preparation of audit reports, should also be required to register.

At its public meeting on March 4, 2003, the Board approved the issuance of PCAOB Release No. 2003-001. See Exhibit 3-A. This release proposed for public comment rules governing the registration of public accounting firms. The comment period on these rules closed March 31, 2003. Also on March 31, 2003, the Board convened a public roundtable at which representatives of various foreign accounting firms, professional organizations, and regulators, and U.S. investors discussed the ramifications of the registration of non-U.S. accounting firms. The members of the Commission also attended the March 31 roundtable. In addition, the Board has received numerous comments addressing the registration of foreign firms.

At its public meeting on April 23, 2003, the Board adopted final registration rules and a registration form. See Exhibits 3-B, 3-C and 3-D. The final rules, consistent with the proposals in Release No. 2003-001, require the registration of foreign public accounting firms that issue audit reports with respect to U.S. issuers, or that substantially participate in such audits. The final rules afford foreign firms an additional 180 days within which to register (*i.e.*, until approximately April 26, 2004). The final registration form allows both U.S. and non-U.S. firms to refrain from submitting information otherwise required in a registration application if the applicant documents the existence of a foreign legal impediment that prevents submission of such

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information. These rules will be promptly submitted to the Commission for approval pursuant to Section 107 of the Act.

To implement the registration program, the Board's staff is developing automated systems for the registration of public accounting firms. The Board anticipates that it will be ready to accept registration applications by June 30, 2003.

4. Inspections

Section 104 of the Act requires the Board to conduct a continuing program of inspections. The purpose of these inspections is to assess the degree of compliance of each registered public accounting firm, and associated persons of that firm, with the Act, the rules of the Board, the rules of the Commission, and professional standards, in connection with its performance of audits, issuance of audit reports, and related matters involving issuers. The Board's Division of Registration and Inspection staff has prepared a paper discussing the inspection program, 2003 goals, and its plan for achieving those goals. See Exhibit 4.

5. Investigations and Disciplinary Process

Section 105(a) of the Act directs the Board to establish, by rule, fair procedures for the investigation and discipline of registered public accounting firms and associated persons of such firms. These rules have not yet been developed. However, the Board's staff has prepared a paper discussing plans concerning investigations, disciplinary proceedings, and the impositions of sanctions against registered public accounting firms and their associated persons. See Exhibit 5.

6. Funding

a. Accounting Support Fee

Section 109(d) of the Act requires the Board to establish, with the approval of the Commission, a reasonable annual accounting support fee (or a formula for the computation thereof) to provide for public company funding of the Board's operations. The rules of the Board must provide for the equitable allocation, assessment, and collection of this fee. At its public meeting on March 13, 2003, the Board approved the issuance of PCAOB Release No. 2003-002. See Exhibit 6-A. This release proposed

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for public comment rules establishing the annual accounting support fee. The comment period on these rules closed April 4, 2003. At its public meeting on April 16, 2003, the Board adopted final rules with respect to the accounting support fee and approved the issuance of a release announcing the final rules. See Exhibit 6-B. These rules were submitted to the Commission for approval pursuant to Section 107 of the Act on April 18, 2003.

The Board expects to finish developing automated systems for the computation and assessment of this fee within the next few weeks. Depending on the timing of the Commission's review of these rules, the Board anticipates sending fee notices to public companies in late May or early June.

b. Assessment, Billing, and Collections

Section 102(f) of the Act requires the Board to assess and collect a registration fee and an annual fee from each registered public accounting firm in an amount sufficient to recover the costs of processing and reviewing applications and annual reports. In addition, as noted above, Section 109(d) requires the Board to establish an annual accounting support fee. The Board's Chief Administrative Officer has prepared a paper discussing the assessment, billing, and collection of these fees. See Exhibit 6-C.

* * *

The Board recognizes that much remains to be done in order to fulfill the vision of the Board set forth in the Act. We believe, however, that we have laid a solid foundation for accomplishing that objective and that the Board satisfies the conditions for the Commission's determination, pursuant to Section 101(d) of the Act, that the Board has the capacity to discharge its responsibilities and to enforce compliance with Title I of the Act. We respectfully request that the Commission make that determination.

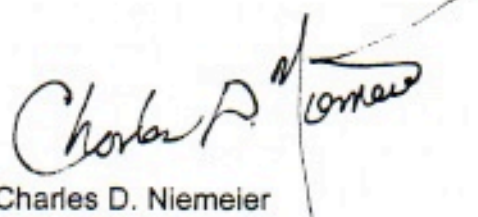
If you or other members of the Commission or its staff have questions regarding the matters discussed in this letter or the Board's status, please feel free to contact any of the members of the Board.

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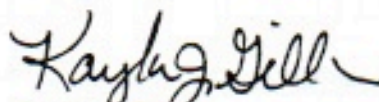
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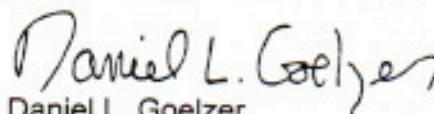
Respectfully submitted.



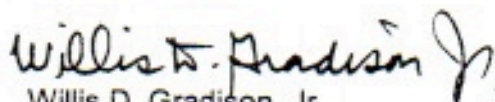
Charles D. Niemeier
Acting Chairman



Kayla J. Gillan
Board Member



Daniel L. Goelzer
Board Member



Willis D. Gradison, Jr.
Board Member

cc: The Honorable Cynthia A. Glassman
The Honorable Harvey J. Goldschmid
The Honorable Paul S. Atkins
The Honorable Roel C. Campos

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EXHIBITS

1. Board Administration

- 1-A Bylaws of the Public Company Accounting Oversight Board, as adopted January 9, 2003
- 1-B Amended Article VI of the Bylaws of the Public Company Accounting Oversight Board, as adopted April 25, 2003
- 1-C Proposed Ethics Code for Members and Employees of the Board
- 1-D Board Budget for the Fiscal Year Ending December 31, 2003
- 1-E Working Paper Regarding the Board's Hiring Process

2. Professional Auditing Standards

- 2-A Establishment of Interim Professional Auditing Standards, PCAOB Release No. 2003-006 (April 18, 2003) and the Board's April 18, 2003 letter transmitting Release No. 2003-006 to the Commission for approval
- 2-B Statement Regarding the Establishment of Auditing and Other Professional Standards, PCAOB Release No. 2003-005 (April 18, 2003)

3. Registration

- 3-A Proposal of Registration System For Public Accounting Firms, PCAOB Release No. 2003-001 (March 7, 2003)
- 3-B Briefing Paper: Auditor Registration System (April 23, 2003)

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- 3-C Section 2 ("Registration and Reporting") of the Rules of the Public Company Accounting Oversight Board (Rules 2100 to 2105), as adopted by the Board on April 23, 2003
- 3-D PCAOB Form 1 ("Application for Registration"), as adopted by the Board on April 23, 2003

4. Inspections

Working Paper Regarding Board Inspections of Registered Public Accounting Firms

5. Investigations and Disciplinary Process

Working Paper Regarding Board Investigations and Disciplinary Proceedings

6. Funding

- 6-A Board Funding: Establishment of Annual Accounting Support Fee, PCAOB Release No. 2003-002 (March 14, 2003)
- 6-B Board Funding: Adoption of Annual Accounting Support Fee, PCAOB Release No. 2003-003 (April 18, 2003)
- 6-C Working Paper Regarding the Assessment and Collection of Board Fees