

December 14, 2009

The Honorable Mary L. Schapiro
Chairman
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Dear Chairman Schapiro:

I am pleased to transmit to you a summary of a performance review entitled "The Public Company Accounting Oversight Board's International Inspections." This performance review was 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 interested in the Board's work with assurance that the PCAOB is achieving the objectives of Title I of the Sarbanes-Oxley Act in an effective manner. IOPA conducts its reviews in conformity with Government Auditing Standards issued by the Comptroller General of the United States.

IOPA undertook this review to determine whether the Board was meeting its goals, as outlined in the Board's Strategic Plan, for international inspections. The Strategic Plan recognizes that, in an increasingly globalized and complex world economy, both U.S. and non-U.S. registered public accounting firms audit financial statements on which investors in U.S. securities markets rely. The Strategic Plan articulates the Board's commitment to addressing the cultural, political, and financial complexities associated with globalization of U.S. issuer auditing.

IOPA's performance review highlights some of the challenges facing the Board's international inspections program. These challenges were compounded by the fact that revelations of widely-reported audit failures outside the U.S., coupled with internal concerns regarding the manner in which international inspections were being performed, have caused the Board to reassess its non-U.S. inspection program. As a result, issuance of inspection reports for certain non-U.S. inspections as to which fieldwork was performed in 2006, 2007, and 2008 was suspended, and the inspections staff began a process of conducting "retrospective reviews" of the quality and consistency of these inspections. As of the date of IOPA's report, 82 reports with respect to pre-2009 foreign inspections have still not been issued, pending completion of these reviews and Board approval of the resulting report.

In addition, the Board's reassessment of its non-U.S. inspections program has resulted in significant changes in the manner in which these inspections will be performed in the future. For example, the Board has recognized the need to increase its focus on the quality control mechanisms of large, global network firms as well as on "referred work" (i.e., work performed by non-U.S. audit firms other than the firm signing the audit report). Further, as IOPA's summary notes, the Director of the Division of Registration and Inspections has initiated changes to the international program, including creating a "national office" structure for the international program; taking initial steps to establish greater staff accountability for international inspections work; assessing the need for additional resources (as reflected in the Board's 2010 budget); and revising significantly the international inspections methodology. I believe that these steps are critical to addressing the concerns raised by IOPA and to putting Board inspections of non-U.S. registered public accounting firms on a more equal footing with those of U.S.-based firms.

The Board intends to publish the attached summary on the PCAOB's Web site on, or shortly after, December 21, 2009. Please feel free to contact me or the Director of IOPA, Peter Schleck (202.207.2085), if you have questions or would like any additional information about IOPA's review or about the Board's international inspections program.

Sincerely,



Daniel L. Goelzer
Acting Chairman

Enclosure: The Public Company Accounting Oversight Board's
International Inspections (IOPA-2009-003) December 4, 2009

cc: The Honorable Kathleen L. Casey
The Honorable Elisse B. Walter
The Honorable Luis A. Aguilar
The Honorable Troy A. Paredes

PERFORMANCE REVIEW

THE PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD'S INTERNATIONAL INSPECTIONS (IOPA-2009-003)

INTERNAL OVERSIGHT AND PERFORMANCE ASSURANCE
December 4, 2009

Background and Objective

The Public Company Accounting Oversight Board's (PCAOB) *Strategic Plan 2008-2013* recognizes that in an increasingly globalized and complex world economy, both U.S. and non-U.S. registered public accounting firms audit financial statements on which investors in U.S. securities rely. Many U.S.-based public companies have branches, subsidiaries, and joint ventures around the world; and many non-U.S.-based companies trade in U.S. markets. As such, the consequences of inaccurate financial reporting and of other financial frauds do not stop at national borders. In its *Plan*, the Board articulates a commitment to working through the cultural, political, and financial complexities associated with globalization.

As of August 2009, 919 non-U.S. firms were registered with the PCAOB. The Division of Registration and Inspections (Division) determined that of this number, 235 had a triennial inspection requirement.^{1/} A total of 51 foreign countries or jurisdictions had at least one firm requiring triennial inspection.

^{1/} As of August 2009, there were no foreign firms that had more than 100 issuer clients. The Division intends to inspect any firm with at least one issuer client once every three years. According to Board Rule 4003(b): "At least once every three years, beginning with the three-year period following the calendar year in which its application for registration with the Board is approved, a registered public accounting firm that, during any of the three prior calendar years, issued an audit report with respect to at least one, but no more than 100, issuers, or that played a substantial role in the preparation or furnishing of an audit report with respect to at least one issuer, shall be subject to a regular inspection."

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The Board's first strategic goal is to promote investor confidence in audited financial statements of public companies through an effective use of a supervisory model of oversight of registered public accounting firms. Included as part of that goal is the conduct of a risk-focused inspection program for registered public accounting firms that evaluates and identifies areas of potential improvement in the practices, processes, and quality controls of these firms; reports the findings to the affected firms; and, determines whether appropriate remediation by the firms has occurred. Sub-objectives relevant to international inspections include:

- Achieving timely issuance of final inspection reports following the completion of inspection fieldwork;
- Continuing to tailor inspection programs for registered U.S. and non-U.S. firms to firm size and nature, while assuring proper consistency across similar inspections, based on risk assessments and other pertinent information; and,
- Fulfilling annual inspection plans consistent with approved schedules and policies, including the Board's reliance policy for inspections of non-U.S. firms.

The *Plan* also includes a goal to further strengthen the effectiveness and coordination of auditor oversight efforts in the United States and abroad. Related language discusses working effectively with international audit regulators to facilitate inspections of non-U.S. registered public accounting firms and strengthening global oversight of auditors of U.S. public companies. In this regard, the *Plan* references implementation of the Board's policy for reliance and cooperation.

Challenges associated with the international inspections program were highlighted to the Office of Internal Oversight and Performance Assurance (IOPA) as we completed our risk assessment for 2009 to establish an analytical basis on which to develop and prioritize a schedule of performance reviews. Some of these same concerns were expressed to us during our 2008 risk assessment. We therefore conducted this review to determine whether the PCAOB was meeting its strategic goals for international inspections.^{2/ 3/}

^{2/} IOPA has also issued two previous reports covering aspects of the inspections program: *Internal Control Review of the PCAOB's Inspection Activities*, December 2005; and *The PCAOB's Large Firm Inspections*, July 2007.

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Responsibilities and Authorities

Section 104 of the Sarbanes-Oxley Act of 2002 requires the PCAOB to conduct a continuing program of inspections to assess registered firms with regard to the performance of audits and related matters. Inspections are to be performed annually for firms that provide audit reports for more than 100 issuers and at least once every three years for most other registered firms that prepare issuer audit reports. The PCAOB is required to provide a written report for each inspection to the Securities and Exchange Commission (SEC), and to make portions of the reports publicly available.

Section 106 of the Act establishes that foreign public accounting firms that provide audit reports are also subject to the Act and the rules of the Board. This section also authorizes the Board to determine that foreign firms playing a substantial role^{4/} in the preparation of audit reports should be treated as public accounting firms for purposes of Board oversight.

Section 4 of the Rules of the PCAOB establishes that inspection steps and procedures will be performed by the staff of the Division of Registration and Inspections (Division) to assess registered firms' compliance with the Act, Board and SEC rules, and professional standards. Rule 4003 establishes the frequency of inspections;^{5/} Rules 4011 and 4012 provide process for and criteria upon which the Board may determine whether, and to what degree, it will rely on an inspection performed by a non-U.S. regulator.

^{3/} 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.

^{4/} Under rules of the Board, the phrase "play a substantial role in the preparation or furnishing of an audit report" means – (1) to perform material services that a public accounting firm uses or relies on in issuing all or part of its audit report with respect to any issuer, or (2) to perform the majority of the audit procedures with respect to a subsidiary or component of any issuer the assets or revenues of which constitute 20% or more of the consolidated assets or revenues of such issuer necessary for the principal accountant to issue an audit report on the issuer.

^{5/} Recent amendments to Rule 4003 are discussed in the full report.

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Within the Division, the Director has established a Deputy Director for International Inspections. The Deputy Director has a "national office" staff of 11 individuals responsible for scheduling, coordinating, and developing and maintaining processes for inspections of non-U.S. firms.

Two other PCAOB Offices also play key roles in support of international inspections. The Office of International Affairs (OIA) represents the Board in discussions and meetings with non-U.S. authorities and negotiates protocols or agreements for cooperation. The Office of Research and Analysis (ORA) performs country- and issuer-specific research, develops quantitative analyses, and creates risk profiles for use by the Division in planning international inspections.

Performance Measures

Performance measures relevant to international inspections listed in the PCAOB's *Strategic Plan* include:

- Conducting 72 non-US inspections in 2008 and 101 in 2009;
- Issuing triennial inspection reports in an average time of 9 months in 2008 and 7 months in 2009.^{6/}

With regard to the average report time, the *Plan* indicates that the PCAOB seeks to issue its inspection reports in a timely manner so the firms can address and remediate any quality control deficiencies identified during the inspection process. Further, this measure is also intended to reflect the Board's commitment to providing the public with timely information about the performance of registered firms.

^{6/} Triennial reports refers to the requirement in Section 104 of Sarbanes-Oxley that firms with 100 or fewer issuer clients be inspected at least once every three years. Time to issue a report is computed from the last day of inspections field work to the date of issuance of the final report.

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Results In Brief

The PCAOB's international inspections program faced a number of significant challenges:

- Field work for 143 inspections had been completed as of August 3, 2009, but only 42 reports had been issued.
- Of the 101 reports not yet issued, 82 constituted a "backlog" that extended to inspections completed in 2006, 2007, and 2008.
- 39 of 82 inspections planned for 2009 had not yet been scheduled. Of these, 28 were in suspense pending the outcome of international negotiations.^{7/}
- Questions had arisen as to the rigor of some international inspections, particularly as concerned documentation, scope, consideration of risk, and reliance on foreign regulators.

The Director of Registration and Inspections indicated that the international inspections program lacked, until recently, a system of accountability. As such, reports had not been drafted in a timely manner. Furthermore, guidance specifically tailored to international inspections evolved more slowly than that for domestic inspections, contributing to an inconsistent approach. Delays in conducting inspections appeared to be largely beyond the control of the Division, and contingency plans were being finalized.

In early 2009, the Director initiated changes to the international program intended to address many of these concerns, including creating a "national office" structure for the international program; taking initial steps to establish specific accountability; assessing the need for additional resources; revising significantly the processes and requirements that constitute the international inspections program methodology; and, subjecting certain completed inspections to "retrospective reviews" of quality and consistency.

The Director's initiatives set, in our judgment, an appropriate tone of urgency. As currently situated, the international inspections program represents a significant risk to

^{7/} Subsequent to IOPA's field work, the Division revised its 2009 schedule by moving forward a number of inspections originally scheduled for 2010 – 2012.

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the Board. A large report backlog will almost certainly embarrass the organization if not expeditiously resolved. Inconsistencies as to approach and documentation may already have put the Board at a disadvantage should the need arise to defend the methodology applied to certain completed inspections. Furthermore, the full extent of risk associated with foreign firms and issuers remains a point of debate that PCAOB staff is only beginning to quantify, relying, in part, on technology systems still in development.

IOPA made a series of recommendations intended to assist the Division in addressing these issues. The Director concurred with the recommendations and detailed a course of action that should, when completed, facilitate continued improvement in the Division's international inspection program.