



April 18, 2023

By Electronic Mail

The Honorable Gary Gensler
The Honorable Hester M. Peirce
The Honorable Caroline A. Crenshaw
The Honorable Mark T. Uyeda
The Honorable Jaime Lizárraga
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Dear Chair Gensler and Commissioners Peirce, Crenshaw, Uyeda, and Lizárraga:

I am pleased to transmit to you a summary of the Public Company Accounting Oversight Board (PCAOB or Board) Office of Internal Oversight and Performance Assurance's (IOPA) Performance Review Report on Third-Party Legal Expenditures and Controls Review (IOPA Review No. 22-OGC-02) (Public). The Board formed IOPA to promote the confidence of Congress, the Securities and Exchange Commission, and the public in the integrity of PCAOB programs and operations. IOPA conducted this review in conformance with the Institute of Internal Auditors' *International Standards for the Professional Practice of Internal Auditing*.

IOPA undertook this review to evaluate the policies, procedures, and controls involved in the procurement, monitoring, and payment of third-party legal services as of September 2022.

As the summary sets forth, IOPA found that policies, processes, and controls related to the procurement of third-party legal services during the relevant period functioned effectively when the Office of the General Counsel (OGC) anticipated and estimated the cost of these services as a routine component of its annual budgeting process. IOPA reviewed the budgeted blanket purchase orders for which OGC requested approval against its 2021 outside counsel expenditures budget and found they were properly documented and approved prior to outside counsel starting work.

During the course of its review, IOPA also found that the PCAOB's procurement guidelines, which provide divisions and offices with the requisite control philosophy and process instructions for directing procurements of goods and services, were not fully effective with respect to unanticipated or unbudgeted circumstances when OGC engaged third-party legal services, and that OGC's cost-estimating and monitoring policies and practices were likewise not sufficiently robust to address spiking cost trajectories in unique circumstances. As such, IOPA identified two areas in which it provides



recommendations it believes will provide better controls for future unanticipated engagements of outside counsel.

The Board has reviewed IOPA's recommendations and management's responses thereto and has approved the transmittal of the summary to you.

The PCAOB intends to publish the attached summary on its website on or about April 28, 2023. Please feel free to contact the Deputy Director of IOPA, Brian Janda, at (202) 549-8329, or me if you have any questions or would like any additional information about the review.

Sincerely,

Erica Williams
Chair

Enclosure: Performance Review Report on Third-Party Legal Expenditures and Controls Review (IOPA Review No. 22-OGC-02) (Public)

Internal Oversight and Performance Assurance

Third-Party Legal Expenditures and Controls Review

IOPA Review No. 22-OGC-02 (Public)

September 2022¹

¹ This date represents the month in which IOPA's audit fieldwork was substantially completed.

EXECUTIVE SUMMARY

Background

During the period from June through September 2022, the Office of Internal Oversight and Performance Assurance (IOPA) of the Public Company Accounting Oversight Board (PCAOB) conducted a review of policies and processes (“Review”) related to the procurement and payment of third-party legal service providers (“Outside Counsel”). Although the PCAOB’s Office of General Counsel (OGC) directly administers the organization’s legal matters to the extent of its own capacity and capabilities, OGC generally retains Outside Counsel on behalf of the PCAOB when additional legal expertise and/or capacity is needed, or to avoid potential conflicts of interest.

Effective 2011, the PCAOB’s procurement guidelines (“Procurement Guidelines”) provide divisions and offices with the requisite control philosophy and process instructions for directing procurements of goods and services. In this report, we refer to standard procurements under an approved purchase requisition (PR) and purchase order (PO) as “in-process” procurements, and procurements with special circumstances that do not allow the requestor to follow the standard process as “out-of-process” procurements. OGC’s procurement and payment of Outside Counsel utilizes blanket purchase orders (BPOs) instead of POs, because the work is not performed under fixed-fee contracts as it might be with the procurement of other goods or services.

Pursuant to the Procurement Guidelines, OGC procures third-party legal services under the following two circumstances:

- Anticipated Services – As part of the annual budgeting process, OGC anticipates and estimates the likely demand for Outside Counsel for the upcoming year. Once the next budget year arrives, OGC: (1) establishes BPOs for Outside Counsel forecasted to provide services in the year ahead, which are routed through OA Procurement’s chain of approval before issuance; and (2) closes out prior-year BPOs.
- Unanticipated Services – In responding to legal service needs that were not anticipated during the annual budgeting process, OGC selects (or assists organizational leadership in selecting) Outside Counsel for the work scope. If Outside Counsel is a firm with whom OGC has a current, open BPO based upon an existing engagement letter covering a similar matter, OGC may commit the new work to the existing BPO. Alternatively, if OGC and the firm have no existing engagement letter to cover the services to be provided, Outside Counsel and the PCAOB would negotiate and enter into an engagement letter covering the new or additional services. Once the engagement letter is signed, OGC initiates a new BPO in the amount estimated to cover the anticipated work for the year.

Approved BPOs represent commitments against program area budgets that have been authorized by the PCAOB and the U.S. Securities and Exchange Commission (SEC). To the extent BPOs for unanticipated services during a given year exceed the budgeted contingency amount, they are considered “out-of-budget” procurements. The SEC’s PCAOB Budget Approval Process specifies that “[f]unds may be disbursed by the PCAOB only in accordance with the Commission approved budget, provided however, during the budget year the PCAOB may transfer amounts totaling not more than \$1,000,000 into or out

of each program area without prior Commission approval.”² If a transfer between programs areas will exceed \$1 million, the PCAOB must submit a supplemental budget request to the SEC for approval.³

By June 2021, the PCAOB had incurred unexpectedly large third-party legal expenses, and the forecasted expenditures for the remainder of the year appeared likely (at least in the absence of significant cost-cutting) to exceed the original OGC 2021 budgeted amount for Outside Counsel fees, even after taking into account an allowed \$1 million transfer between program areas. IOPA’s Review evaluated OGC’s processes for supporting the PCAOB in its procurement of Outside Counsel, and subsequently estimating the potential cost for anticipated services, requesting the BPO, and monitoring the cost incurred.

OGC subsequently drafted and preliminarily implemented procedures related to retaining and managing the cost of Outside Counsel. OA Procurement also drafted a forthcoming procurement policy (“Procurement Policy”) to replace the existing Procurement Guidelines.

Objective and Scope

The purpose of our Review was to evaluate the policies, procedures, and controls involved in the procurement, monitoring, and payment of third-party legal services as of September 2022.

To accomplish our objective, we:

1. Reviewed and evaluated documented policies and procedures guiding the procurement of third-party legal services;
2. Interviewed relevant OGC and OA Procurement personnel to gain an understanding of processes surrounding the procurement of third-party legal services;
3. Performed detailed sample testing of a selection of BPOs and invoices for third-party legal services;
4. Reviewed internal controls over financial reporting relative to the procurement and payment for third-party legal services; and
5. Performed limited e-Discovery procedures.

We conducted our review in conformance with the Institute of Internal Auditors’ *International Standards for the Professional Practice of Internal Auditing*.

Summary Results and Conclusion

Our testing indicated that policies, processes, and controls related to the procurement of third-party legal services during the relevant period functioned effectively when OGC anticipated and estimated the cost of these services as a routine component of its annual budgeting process. We reviewed the budgeted BPOs for which OGC requested approval against its 2021 Outside Counsel expenditures budget and found they were properly documented and approved prior to Outside Counsel starting work.

² 17 § CFR 202.190(e)(2).

³ 17 § CFR 202.190(f)(1).

However, we found that the Procurement Guidelines were not fully effective with respect to unanticipated or unbudgeted circumstances when OGC engaged third-party legal services, and that OGC's cost-estimating and monitoring policies and practices were likewise not sufficiently robust to address spiking cost trajectories in unique circumstances.

We identified two moderate risk areas in which we provide OGC and OA with recommendations we believe will provide better controls for future unanticipated engagements of Outside Counsel.

OGC and OA provided responses indicating concurrence with our audit observations and a commitment to corrective actions that are responsive to our recommendations.

We thank all personnel who supported our review, both at the senior management and staff operating level, for their courtesy and cooperation throughout this assessment.

APPENDIX

Appendix A – Risk Classifications and Definitions

To provide the reader with further perspective of the degree of risk IOPA attributes to each audit observation, we have assigned color-coded risk ratings as explained in the legend below.

Degree of Risk and Priority of Action	
Material	The degree of risk is unacceptable and poses a significant level of financial, compliance or operational risk to the organization. As such, complete remediation is generally required on a highest priority basis.
Significant	The degree of risk is undesirable and poses a significant financial, compliance or operational risk to the organization. As such, complete remediation is generally required on a high priority basis.
Moderate	The degree of risk is undesirable and poses a moderate financial, compliance or operational risk to the organization. As such, complete remediation is generally required on a medium priority basis.
Low	The degree of risk appears reasonable but there are opportunities to further reduce risk through improvements to existing policies, procedures, and/or operations. As such, on a lower priority basis, management should take actions to reduce the risks to the organization.

IOPA used its professional judgement in determining the overall ratings presented in the Executive Summary of this report. The report is intended to provide management with information about the condition of risks and internal controls at a point in time.