AGENDA ITEM B.1

PCAOB
Public Company Accounting Oversight Board

The Public Company Accounting Oversight Board

The Public Company Accounting Oversight Board is a private, nonprofit organization established by Congress to oversee the auditors of public companies.

The PCAOB was created to protect investors and the public interest by promoting informative, fair, and independent audit reports.

The Board began operations in 2003, not long after passage of its chartering legislation, the Sarbanes-Oxley Act of 2002.

The Sarbanes-Oxley Act required that auditors of public companies whose stock is traded on U.S. exchanges -- and other "issuers," as defined by the Securities Exchange Act of 1934 -- be subject to external and independent oversight for the first time in history. Previously, the profession was self-regulated.

Today, auditors of public companies are supervised by the PCAOB, primarily through its authority to set auditing and related professional-practice standards, to inspect firms for compliance with these standards, and to take enforcement actions, if needed, to bring firms into compliance. Presently, auditors of nonpublic broker-dealers are required to register with the PCAOB, although they are not subject to PCAOB inspections and enforcement authority.

The five members of the PCAOB Board are appointed to staggered five-year terms by the Securities and Exchange Commission (SEC). The SEC has oversight of the PCAOB, including approval of all Board rules, standards, and its budget.

The Sarbanes-Oxley Act established funding for PCAOB activities primarily through annual fees assessed on public companies in proportion to their market capitalization. The Board's current calendar-year budget is $157.6 million.

- **Registration and Reporting of Audit Firms**

  The Sarbanes-Oxley Act, along with the Board's rules, requires that accounting firms register with the PCAOB if they prepare or issue an audit report for a U.S. public company, or play a substantial role in the preparation or furnishing of an audit report, for a U.S. public company.

  By order of the Securities and Exchange Commission, registration of auditors of nonpublic broker-dealers had not been necessary. As a result of the SEC Order's recent expiration (year-end 2008), absent further action by the SEC, financial statements of nonpublic broker-dealers for fiscal years ending after December 31, 2008, must be certified by a registered accounting firm.

PCAOB
Public Company Accounting Oversight Board

Both domestic and foreign accounting firms must register. As of August 11, 2009, there were 2,120 accounting firms registered with the PCAOB; approximately 1,197 are domestic firms and 923 are foreign firms, based in 86 countries and one special province.

Under Board rules, effective October 12, 2009, registered firms must file timely special reports with the Board if certain specified events occur, and, beginning in 2010, every registered firm must file an annual report and pay an annual fee. Annual reports are due by June 30 of each year for the 12-month period ending March 31 of that year. Annual fees are due by July 31.

Standard Setting

Congress charged the PCAOB with establishing auditing and other professional standards to govern public company audits. The PCAOB has an established process of review and discussion of its standards proposals, including a public-comment period. These comments are published and play a significant role in the development of the Board's standards. Once a standard is adopted by the PCAOB, it is submitted to the SEC, and does not become effective until approved by the SEC.

The Board created a Standing Advisory Group in 2003 to assist and advise on standard-setting issues and challenges. The advisory group currently has 33 members, who are drawn from a cross section of representative groups, including public companies, auditors from small and large accounting firms, investors and their advisers, academics, and other regulators. These individuals share their informed opinions about best practices and emerging issues with the Board, as well as how they believe the Board may improve the quality of audits, consistent with its statutory mandate.

Inspection of Audit Firms

Once registered, most accounting firms begin a continuous cycle of PCAOB annual or triennial inspections of their audits of issuers. Under Board rules, a registered accounting firm that provides audit reports for more than 100 issuers in any calendar year is inspected the following year. Firms are inspected at least once every third year if they prepare audit reports for up to 100 issuers. Many registered firms are not subject to regular inspection by the PCAOB because, to date, they have not performed audit work that brings them within the scope of the inspection requirement.

The PCAOB issues a written inspection report on each inspection, portions of which are made available to the public on the Board's Web site. Under the Sarbanes-Oxley Act and the Board's rules, portions of an inspection report that deal with criticisms of, or potential defects in, the firm's quality control systems are not made public if the firm addresses those matters to the Board's satisfaction within 12 months after the report date. Those portions are made public, however, if the firm does not satisfactorily address the criticisms or potential defects within that time period.

In addition to regular inspections, special inspections may be initiated at any time to review new information garnered from sources, such as SEC filings, investigations by other regulators, and information from news reports, professional associations, or members of the public.

PCAOB
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- **Investigation and Discipline of Audit Firms**

  Congress gave the PCAOB significant powers to investigate and discipline registered audit firms and their accountants for non-compliance with the Sarbanes-Oxley Act, the PCAOB rules, the securities laws, and SEC rules on the preparation and issuance of audit reports of public companies, and professional standards.

  When violations are found, the PCAOB can impose appropriate sanctions, including temporarily or permanently prohibiting a firm or associated person from participating in audits of public companies. Any sanctions imposed by the PCAOB are subject to SEC review.