

## **Public Company Accounting Oversight Board – 2016 Budget**

### **Summary of the Supplemental Budget Request for the PCAOB Inspection Program Area, Submitted by the PCAOB to the Securities and Exchange Commission on October 14, 2016**

The Public Company Accounting Oversight Board (“PCAOB” or “Board”) is submitting a supplemental budget request to reallocate funds between program areas within its approved 2016 Budget in order to carry out its planned inspection program. Specifically, the PCAOB is requesting approval to transfer up to \$1 million in budgeted 2016 funds into its inspection program area, over and above the \$1 million the PCAOB already is permitted to transfer under the SEC’s Budget Rule.<sup>1</sup>

Granting this request would not increase the PCAOB’s 2016 Budget or affect the issuer or broker-dealer accounting support fee in any way. Nor would it materially change the staffing or planned scope of PCAOB inspections above the levels assumed in the approved 2016 Budget. It would, however, account for the fact that, for the reasons explained below, the PCAOB estimates that its 2016 spending for the inspection program area will exceed the 2016 Budget by more than the \$1 million limit allowed for transfers under in the Budget Rule.

This letter sets forth the background and justification for this request. Specifically, consistent with the SEC’s Budget Rule, this letter includes: (1) a statement regarding how the supplemental budget facilitates the PCAOB’s strategic and policy goals; (2) information regarding the impact of the supplemental budget on each affected program area and the proposed source of funds; and (3) information indicating why the request was not included in the PCAOB’s 2016 Budget and why the request cannot be incorporated as part of the 2017 Budget process.

### **Background**

The SEC’s Budget Rule specifies, in part, 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.”<sup>2</sup> “Program area” is defined as “the array of the budgeted amounts and other budget-related data according to the major purpose served, such as registration, inspection, standard-setting, enforcement, and administration.”<sup>3</sup>

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<sup>1</sup> 17 CFR § 202.190.

<sup>2</sup> See 17 § CFR 202.190(e)(2); 71 Fed. Reg. 41998, 42003 (July 24, 2006) (emphasis in original).

<sup>3</sup> See 17 CFR § 202.190(b)(7); 71 Fed. Reg. 41998, 42002 (July 24, 2006). Also see Appendix A for the 2016 Budget by Program Area, provided as Table 5 in the PCAOB’s 2016 Budget and Budget Justification (November 30, 2015).

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The approved 2016 Budget for the PCAOB's inspection program area is \$125,092,048.<sup>4</sup> The Board's ongoing inspection program is the primary means through which it can affect the conduct of audits and thereby protect investors from deficient auditing and the attendant risks to reliable and accurate financial reporting. Inspections is, by far, the PCAOB's largest program area, with the \$1 million limit representing less than one percent of the inspection program's approved 2016 Budget.<sup>5</sup>

The 2016 Budget contemplated that the inspection program would carry out 212 issuer-audit inspections, including the six large domestic firms that collectively audit more than 98.9% of issuer market capitalization. The 2016 Budget also contemplated inspections of 75 firms that audit broker-dealers, including the review of portions of 115 of those firms' broker-dealer audit and attestation engagements.

Our experience through late July 2016 had led us to believe that the amount budgeted in 2016 for inspections travel was too low to conduct (1) the inspections assumed in the 2016 Budget, and (2) the additional travel associated with inspections that were not assumed in the 2016 Budget either because access to those countries had not yet been established at the time the 2016 Budget was prepared or regulatory agreement had not yet been reached on the firms that would be inspected in 2016. This underestimate of inspection travel costs, coupled with greater success hiring inspectors at the end of 2015 and a slightly lower attrition rate thus far in 2016, produced in July a year-end 2016 Estimate for inspections that was \$3.4 million more than budgeted.

Subsequently, as of September 30, 2016, the PCAOB had spent \$96 million on the inspection program, year to date, which is approximately \$630,000, or 0.7 percent, over the budgeted amount for that same period. This overspend is expected to increase by year end and cause the inspection program to exceed its 2016 Budget by more than the \$1 million limit in the SEC's Budget Rule. As of September 30, 2016, the re-forecasted year-end spend for the inspection program area for 2016 is estimated to be as much as \$127.1 million – \$2 million more than budgeted,<sup>6</sup> largely due to underestimating inspection-related travel costs and changing assumptions on the mix of

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<sup>4</sup> The budget of Division of Registration and Inspections ("DRI") is split between two program areas: registration and inspection.

<sup>5</sup> See Appendix B for an illustration of the varying impact of the Budget Rule's \$1 million allowable transfer limit across PCAOB program areas.

<sup>6</sup> The current estimate is that the inspection program will spend \$1.5 million more than budgeted for 2016. However, in light of the fact that extremely small changes in outlays (amounting to less than one-half of one percent of the amount budgeted for the inspection program area) can affect total outlays by \$0.5 million, the uncertainty around the projection suggests it is prudent to request the marginal flexibility, especially since the resources are available from underspends in other program areas.

firms and audits to be inspected in light of more recent data and experience.<sup>7</sup> As a result of the measures taken, the current estimated overspend of up to \$2 million for the inspection program area is less than the \$3.4 million overspend projected in the 2016 Estimate in the 2017 Preliminary Budget.

DRI has been closely monitoring its travel and other inspection expenses and has implemented certain measures for the remainder of 2016 to reduce costs, including making adjustments to inspections staff travel and its planned inspections. Despite these efforts, expenditures in the inspection program area are still expected to exceed the approved 2016 Budget by more than \$1 million.

### **Justification and Resource Effects**

1. **Supplemental Budget's Facilitation of the PCAOB's Strategic and Policy Goals**

Approval of this supplemental budget request would facilitate the PCAOB's strategic and policy goals.<sup>8</sup> If the PCAOB is not permitted to transfer the funds requested, DRI's ability to complete all statutorily mandated inspections this year would be severely impaired as DRI will have insufficient funds to both complete its inspection of all portions of audits planned for the largest U.S. firms and conduct inspections of certain non-U.S. firms that have 2016 and earlier inspection deadlines.

2. **Impact of the Supplemental Budget on Each Affected Program Area and Proposed Source of Funds**

The PCAOB does not expect the supplemental budget request to have a material effect on any other program area.<sup>9</sup> The reallocation of funds to the inspection program area up to the \$1 million limit is being funded by underspends in the program areas of administration (\$0.5 million), economic and risk analysis (\$0.3 million), and standard-setting (\$0.2 million). The additional \$1 million in reallocated funds above the limit would come from additional underspends in economic and risk analysis (\$0.7 million) and standard-setting (\$0.3 million).

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<sup>7</sup> Our staff continues to spend substantial time reevaluating and improving its methodology for estimating the costs of inspections travel. Considering projections for 2016 and 2017 included in the 2017 Preliminary Budget along with actual spending for the past four years, the PCAOB's travel spending since 2012 has remained quite consistent at \$14-15 million per year.

<sup>8</sup> Several goals and objectives in the Board's current Strategic Plan 2015-2019, dated November 30, 2015, provide a framework for DRI's planned scope of inspection activities. See Appendix C for inspection program-related goals and objectives in the 2015-2019 PCAOB Strategic Plan.

<sup>9</sup> See Appendix D for a chart outlining the reallocation of funds to the inspection program area.

The underspend in the economic and risk analysis program area is available because the Office of Research and Analysis and the Center for Economic Analysis had fewer positions filled over the course of the year than budgeted and have been spending less than budgeted on consulting. The underspend in the standard-setting program area is available because the Office of Chief Auditor has had vacated positions that have not been filled and is not holding certain roundtable meetings that had been budgeted. The underspend in the administration program area is available because of lower spending in consulting and recruiting. As all of these underspends are anticipated to be permanent underspends for 2016, transferring such amounts to the inspection program area would not have an effect on these program areas.

### 3. Information Related to the Timing of the Request

This request was not included in the PCAOB's 2016 Budget because the 2016 Budget for inspections travel was based on assumptions that have not borne out and appear to have been underestimated in light of more recent travel cost experience as compared to the data that was used at the time the 2016 Budget was formulated. A combination of factors, including the mix of assumptions, the methodology for calculating cost per trip, and the yet-unavailable data related to higher travel spending in the fourth quarter of 2015 resulted in an unrealistically low 2016 travel budget for DRI.

Moreover, this request cannot be postponed and incorporated into the Board's 2017 Budget as these additional resources may be needed for DRI to carry out its planned inspection program contemplated in the 2016 Budget. If this request were delayed or not approved, DRI would need to take a mix of further actions for the remainder of the year to avoid spending more than \$1 million over the amount budgeted for 2016.

- Appendix A 2016 Budget by Program Area 2014-2016
- Appendix B \$1 Million Allowable Transfer Limit as a Percentage of Program Area Budget
- Appendix C Inspection Program Area-Related Goals and Objectives in the 2015-2019 PCAOB Strategic Plan
- Appendix D Reallocation of Funds to the Inspection Program Area

**Appendix A**

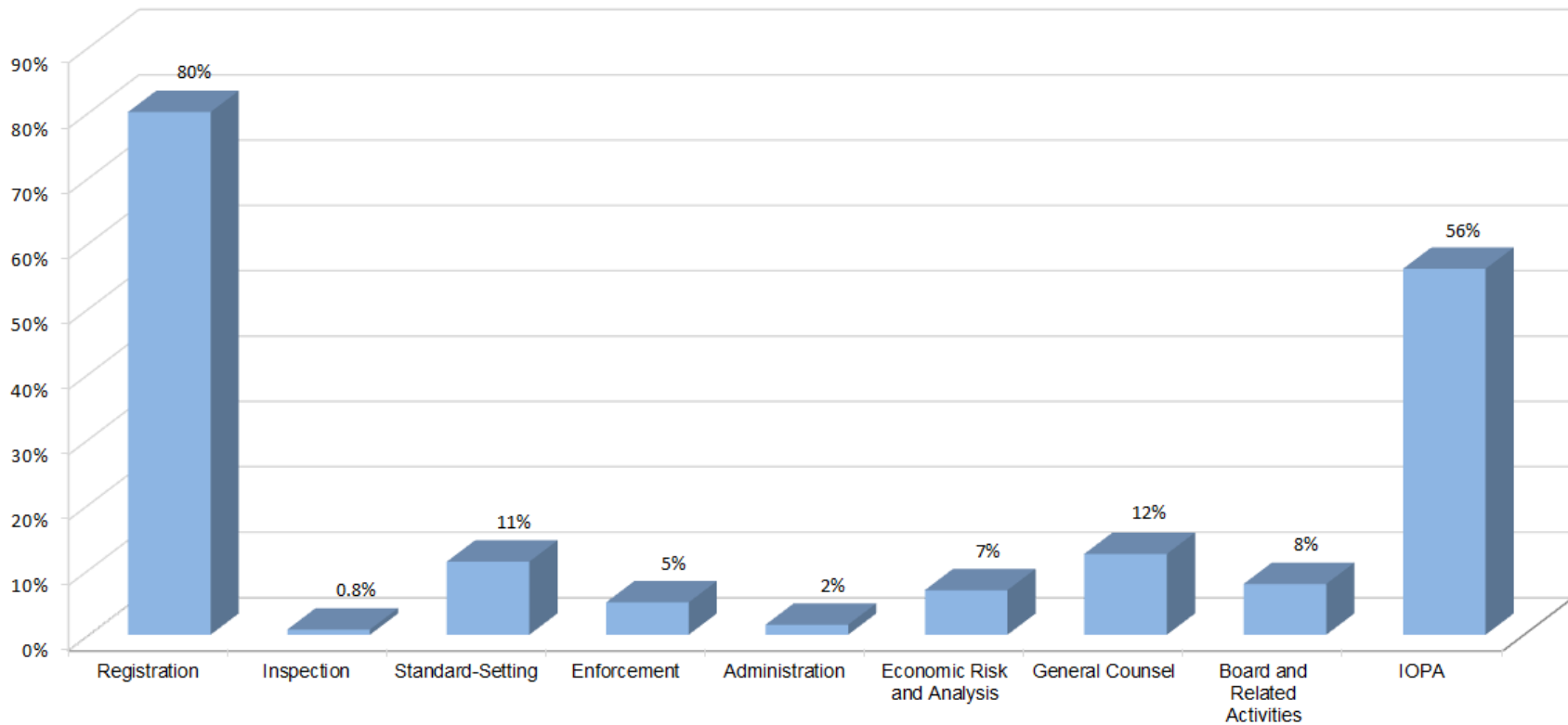
**2016 Budget by Program Area 2014-2016 \***

<b>Program Area (in bold)</b>	<b>2014 Actuals</b>	<b>2015 Budget</b>	<b>2015 Estimate</b>	<b>2016 Budget</b>
<b>Registration</b>	1,111,320	1,202,071	1,211,858	1,249,623
<b>Inspection</b>	119,709,656	124,435,300	124,129,790	125,092,048
<b>Standard-Setting</b>	7,979,253	8,973,452	8,203,527	8,940,382
<b>Enforcement</b>	17,784,160	19,134,615	18,791,496	20,163,791
<b>Administration</b>				
--Office of Administration	35,093,139	37,611,906	34,044,007	38,257,258
--Office of Information Technology	22,956,679	25,000,057	24,960,106	26,673,093
Sub-total	58,049,818	62,611,963	59,004,114	64,930,351
<b>Economic and Risk Analysis</b>				
--Office of Research and Analysis	8,389,488	9,489,144	8,002,548	8,950,191
--Center for Economic Analysis	754,486	2,278,901	3,904,207	5,678,994
Sub-total	9,143,974	11,768,046	11,906,754	14,629,185
<b>General Counsel</b>	7,199,405	7,877,236	7,325,251	8,075,495
<b>Board and Related Activities</b>				
--Board and Executive Staff	6,481,054	7,565,627	7,517,087	7,233,195
--Office of International Affairs	2,980,161	3,167,877	2,968,440	3,150,630
--Office of Outreach and Small Business Liaison	1,225,573	1,272,203	1,100,156	1,276,406
--Office of Public Affairs	529,600	672,491	607,371	687,456
--Office of Government Relations	463,950	485,582	482,297	504,036
Sub-total	11,680,337	13,163,779	12,675,352	12,851,724
<b>Internal Oversight and Performance Assurance</b>	1,610,634	1,715,498	1,666,197	1,784,688
<b>Total</b>	<b>234,268,558</b>	<b>250,881,960</b>	<b>244,914,339</b>	<b>257,717,287</b>

\* Provided as Table 5 in the PCAOB's 2016 Budget and Budget Justification (November 30, 2015).

**Appendix B**

**\$1 Million Allowable Transfer Limit as a Percentage of Program Area Budget**



## **Appendix C**

### **Inspection Program Area-Related Goals and Objectives in the 2015-2019 PCAOB Strategic Plan**

#### **Goal 1: Effective Oversight**

Objective A: Through research, risk analysis, and standard setting, effectively and efficiently respond to emerging audit risks and trends

Objective B: Through inspections and enforcement actions and initiatives, respond to audit opinions issued without reasonable basis, understand root causes of deficiencies, and communicate insights on audit practices

Objective C: Further develop a regulatory and operational infrastructure to carry out oversight authority relating to broker-dealer auditors

Objective D: Communicate to investors, preparers, auditors and other public constituencies analyses and results of PCAOB oversight activity, consistent with the framework of the Act

Objective E: Reinforce and extend the emerging cross-border audit oversight regime, consistent with the particular needs and circumstances of the participants

#### **Goal 2: Constructive Impact**

Objective B: Enhance auditors' independence, objectivity and professional skepticism

Objective C: Improve transparency related to the PCAOB's activities and information relating to all categories of registered public accounting firms

Objective D: Where possible, consistent with the Act and our mission, engage stakeholders to contribute to improving the quality of corporate governance

Objective E: Build upon relationships and contribute leadership to establish effective and practical cross-border oversight of auditing to the global economy

Objective F: Use the Center to enhance the use of economic analysis, empirical tools and analysis, and performance measures throughout PCAOB programs

#### **Goal 3: Dedicated People**

Objective A: Attract, retain and develop a highly skilled, diverse and innovative staff with the utmost integrity

Objective B: Promote the careful stewardship of PCAOB resources

**Appendix D**

**Reallocation of Funds to the Inspection Program Area**

<b>Inspection Program Area</b>		<b>Funds Available for Transfer from Other Program Areas</b>	
2016 Budget	125,092,048		
Transfers to(+)/from(-) Allowed Under Budget Rule	1,000,000	(200,000)	Standard-Setting
		(300,000)	Economic and Risk Analysis
		(200,000)	Office of Research and Analysis
		(100,000)	Center for Economic Analysis
		(500,000)	Administration
		(500,000)	Office of Administration
		-	Office of Information Technology
Amount Allowed to be Spent Under Budget Rule	126,092,048		
Transfers to(+)/from(-) Assumed in Supplemental Budget Request	1,000,000	(300,000)	Standard-Setting
		(700,000)	Economic and Risk Analysis
		(400,000)	Office of Research and Analysis
		(300,000)	Center for Economic Analysis
2016 Spending Level Assumed in Supplemental Budget Request	127,092,048		