

August 7, 2006

The Honorable Christopher Cox  
Chairman  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549

Dear Chairman Cox:

I am pleased to transmit to you summaries of the Public Company Accounting Oversight Board's most recent performance reviews, 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 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 conformance with Government Auditing Standards issued by the Comptroller General of the United States.

These reviews discuss activities conducted by the Board's Division of Enforcement and Investigations and Office of the Chief Auditor. Both of these reports are part of a series of reports that IOPA performed to assess the progress of key PCAOB programs and functions in establishing effective and appropriate internal controls. The Board is very supportive of IOPA's review process.

The Board intends to publish the attached summaries of IOPA's reviews on the PCAOB's Web site on or about August 14, 2006. You and your staff should feel free to contact me or the Director of IOPA, Peter Schleck (202-207-9115), if you have any questions or would like any additional information about the reviews.

Sincerely,



Mark Olson  
Chairman

cc: Paul S. Atkins, Commissioner  
Roel C. Campos, Commissioner  
Annette L. Nazareth, Commissioner  
Kathleen L. Casey, Commissioner

---

---

## **PERFORMANCE REVIEW**

### **INTERNAL CONTROL REVIEW OF THE PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD'S DIVISION OF ENFORCEMENT AND INVESTIGATIONS (IOPA-2006-002)**

#### **INTERNAL OVERSIGHT AND PERFORMANCE ASSURANCE July 18, 2006**

---

---

#### **Objective and Background**

On a regular basis, Internal Oversight and Performance Assurance conducts risk assessments of the Public Company Accounting Oversight Board's ("PCAOB" or the "Board") major programs and functions. Based on assessments conducted to date, we designed a series of performance reviews to assess the progress of key PCAOB programs and functions in establishing effective and appropriate internal controls over operations. As part of each review, Internal Oversight and Performance Assurance identifies and reports on the status of and any plans to enhance internal controls. Previous reports in this series have discussed controls in place over information technology and security, human resources, finance, inspections, research and analysis, and the Board's standard's setting activities. This report focuses on the Division of Enforcement and Investigations (DEI).<sup>1/</sup>

The statutory basis for PCAOB Enforcement is Section 105 of the Sarbanes-Oxley Act of 2002 (the "Act"), which provides that –

The Board shall establish, by rule, subject to the requirements of the Act, fair procedures for the investigation and disciplining of registered public accounting firms and associated persons of such firms.

---

<sup>1/</sup> 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.

## **PERFORMANCE REVIEW**

The Act further specifies that in accordance with the rules of the Board, the Board may conduct investigations of any act or practice, or omission to act, by a registered public accounting firm, including any associated person of such firm, that may violate any provision of the Act, the rules of the Board, the provisions of the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, including the rules of the Securities and Exchange Commission (SEC) issued under the Act, or professional standards. The Board may also initiate disciplinary proceedings based on its investigations.

In 2004, the Board established the Division of Enforcement and Investigations to carry out its investigative and enforcement responsibilities. Section 5 of the Rules of the Board establishes the basic framework for the PCAOB's investigation and adjudication process, including conducting inquiries and investigations; commencing disciplinary proceedings; imposing related sanctions; and conducting Board hearings. In addition, Section 5 delegates to the Director of Enforcement and Investigations the responsibility to conduct inquiries and investigations. As of March 2006, the Division included a total of 24 full-time regular personnel consisting of attorneys, accountants, administrative staff, paralegals, and one research analyst all based in Washington, D.C.

As with our previous reviews in this internal control series, we recognize that the PCAOB is a blend of organizational cultures that was established as a private sector entity yet charged with a public interest mission. Moreover, the Board has articulated its desire to foster a creative, non-bureaucratic work environment that encourages informed risk-taking and innovative strategies to achieve the PCAOB's statutory mandates. Our reviews are intended to help ensure that within this unique framework, PCAOB offices continue to establish robust internal standards, policies, procedures, and professional practices to guide operations on a day-to-day basis.

For purposes of this review, we generally use the term "internal control" as defined by the Committee of Sponsoring Organizations ("COSO") of the Treadway Commission, reproduced below.

Internal control is broadly defined as a process, effected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- Effectiveness and efficiency of operations.

## **PERFORMANCE REVIEW**

- Reliability of financial reporting.
- Compliance with applicable laws and regulations.

While the COSO definition includes internal control relevant to financial reporting, it is important to note that COSO-defined controls also encompass business operations and the legal and regulatory framework in which an entity operates. Our review included all of these aspects of internal control, but it was not designed to allow us to express an opinion on internal controls over financial reporting in accordance with PCAOB Auditing Standard No. 2.<sup>2/</sup> COSO's broad-based view of internal controls is consistent with Internal Oversight and Performance Assurance's charter to help ensure the efficiency, effectiveness, and integrity of PCAOB programs and operations.

### **Results of Review**

Based on our analysis of documents provided by the Division of Enforcement and Investigations, discussions with the Director of Enforcement, and interviews with DEI personnel and other PCAOB staff, we identified many positive accomplishments and ongoing initiatives that have facilitated DEI's ability to successfully carry out the Board's investigative and enforcement responsibilities. We noted for example, that DEI –

- Formalized the process for receiving anonymous tips, complaints, or other pertinent information from the public or government sectors concerning any matter relating to the PCAOB and its responsibilities under the Sarbanes-Oxley Act of 2002. DEI has formalized this process through the creation of a TIPS manual, which outlines internal procedures for DEI staff to organize, document, track, and close tips and complaints within PCAOB. As of March 2006 DEI has received over 200 tips via e-mail, telephone calls, mail, and facsimile. Information received has included potential violations, by registered public accounting firms, of the Act, the rules of the PCAOB, or other applicable laws. Tips are forwarded to those divisions and offices within the PCAOB which are best suited to take advantage of the tips' information. In some instances, information has been relevant to PCAOB inspections of registered public accounting firms

---

<sup>2/</sup> PCAOB engages an independent accounting firm to audit its annual financial statements.

## PERFORMANCE REVIEW

or other work of the PCAOB. As of March 2006, approximately 9 tips were the source of ongoing inquiries or formal investigations.

- Developed and conducted a one-day Enforcement training program. The January 2006 training session was held for DEI's attorneys, accountants, and support staff and covered such topics as PCAOB standards, forensic accounting, the inspection process, the investigative process, and coordinating with the Office of General Counsel. Certain Board members, their staff and other PCAOB staff also attended the program and made presentations. The focus of the training was to give a general overview of the process for conducting investigations and coordinating with other PCAOB divisions.
- Deployed the first phase of a Case Management System (CMS). The CMS assists DEI staff in conducting investigations by tracking and recording all information relevant to matters being pursued including parties involved and related information about the parties, dates, matter numbers, staff assigned, status of a matter, and document creation. The system provides a process workflow for DEI staff to follow, which includes dates when documents must be requested and/or received as well as dates for key events. In addition, the document creation function facilitates the use of standardized documents and templates to be used in every investigation.
- Developed a public source analysis process to assist in identifying potential cases. In addition to receiving leads for inquiries and investigations from the traditional sources such as issuer disclosures, TIPS, and other PCAOB divisions and offices and other regulators, DEI developed a public source analysis process. Using information from various data providers, DEI's research analyst conducts a daily analysis of restatement announcements, auditor changes/dismissals, and a review of news sources and produces a report reviewed by DEI management.
- Established guidelines for coordinating periodically with SEC Enforcement officials. Because PCAOB has overlapping enforcement jurisdiction with SEC it is critical that coordination between PCAOB and SEC enforcement staff takes place. DEI has established written guidelines on referrals, communicating, and sharing documents and other information with SEC

## **PERFORMANCE REVIEW**

enforcement staff. Additionally, in order to maximize effective coordination with SEC Enforcement, DEI staff meets regularly with the SEC's Chief Accountant for Enforcement and her staff to discuss significant developments in DEI's investigations and inquiries.

We also made observations DEI leaders may wish to consider as they continue to develop and enhance the infrastructure supporting the enforcement and investigation processes. Based on our observations, we recommended that the Director of Enforcement and Investigations finalize a guidelines and procedures manual and document procedures for maintaining electronic and paper investigative files. The Director concurred with the recommendations.