

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 OFFICE OF CHIEF AUDITOR (IOPA-2006-001)

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 in establishing effective and appropriate internal controls over operations of key PCAOB programs and functions. As part of each review, Internal Oversight and Performance Assurance identifies and reports on the status of internal controls and any plans to add to, enhance, or benchmark those controls against existing standards. Previous reports in this series have discussed controls in place over information technology, human resources, finance, inspections, and research activities. This report^{1/} focuses on the Office of Chief Auditor.

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,

^{1/} 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.

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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.
- 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. COSO's broad-based view of internal controls is consistent with Internal Oversight and Performance Assurance's charter to help insure the efficiency, effectiveness, and integrity of PCAOB programs and operations.

Section 103 of the Sarbanes-Oxley Act of 2002 directs the Board to establish auditing and related attestation, quality control, ethics, and independence standards and rules to be used by registered public accounting firms in the preparation and issuance of audit reports as required by the Act or the rules of the Securities and Exchange Commission. The Board's Office of the Chief Auditor advises the Board on the establishment of such auditing and related professional practice standards.

The Office of Chief Auditor ended 2005 with 14 staff members and expects to add more staff in 2006. During the course of this review, the PCAOB's first Chief Auditor left the organization for personal reasons and was succeeded by his Deputy.

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Results of Review

Based on our analysis of documents provided by the Office of Chief Auditor, discussions with the Chief Auditor, and interviews with PCAOB Board members and the Office of Chief Auditor and other PCAOB staff, we identified many positive accomplishments and ongoing activities that have facilitated the statutory missions of the PCAOB. We noted for example, that since the doors of the PCAOB opened in 2003, the Office of Chief Auditor has:

- Drafted and advised the Board on four new audit standards that have been approved by the Securities and Exchange Commission (SEC).
- Helped the Board develop new ethics and independence rules.
- Assisted the Board, along with the Division of Registration and Inspections, in developing its Report on the Initial Assessment of Implementation of Auditing Standard No. 2.
- Issued a series of 55 questions and answers regarding Auditing Standard No. 2.
- Issued guidance on audits of financial statements of non-issuers performed pursuant to the standards of the PCAOB.
- Issued guidance for attest engagements regarding XBRL^{2/} financial information furnished under the XBRL Voluntary Financial Reporting Program on the Commission's EDGAR System.
- Administered PCAOB's Standing Advisory Group.

^{2/} XBRL (eXtensible Business Reporting Language) is an open standard for electronic communication of business and financial data. The XBRL standard provides a format for tagging that data so users can extract, exchange, analyze, and present the information.

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- Held research symposiums, which served as catalysts for independent research projects by academia to synthesize existing research on topics of interest to the PCAOB.
- Represented the Board as observers at international standards-setting forums.
- Liaised with various outside organizations such as the SEC, the Financial Accounting Standards Board, the Government Accountability Office, federal banking regulators, the American Institute of Certified Public Accountants, Financial Executives International, and the International Organization of Securities Commissions.
- Acted as in-house consultant to other PCAOB units and worked closely with them as they carried out their own responsibilities.

We also observed, however, that certain efforts could benefit from more structure in the form of policies or procedures to enhance internal controls and mission attainment. We identified three main areas that, in our judgment, could benefit from well-thought out but appropriately flexible guidance:

- **Internal processes for advising the Board on rulemaking or promulgating staff guidance.** While the PCAOB has considerable structure over its external rulemaking process, the Office of Chief Auditor has less structure around its internal processes for advising the Board on rulemaking or promulgating staff guidance, including Board and other PCAOB office involvement. As such, OCA may wish to consider additional documentation regarding approach, structure, and potential performance milestones for standards-related projects. OCA has outlined, in draft, the basic steps for standards development. This may serve as a good starting point for developing a flexible but disciplined approach.
- **Communication with parties external to the PCAOB.** In establishing and monitoring implementation of auditing and related standards and rules to be used by registered public accounting firms in the preparation and issuance of audit reports, the PCAOB has established some effective mechanisms to facilitate communication with external parties including the

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Standing Advisory Group. The Office of Chief Auditor's interaction with other external parties may benefit from a similar structure.

- **Updating the Standards section of the PCAOB Web site.** The Standards section of the PCAOB Web site is the primary means of communication of PCAOB standards, rules, and staff guidance. In addition to the Office of Chief Auditor, other offices within the PCAOB are involved in maintaining the Web site. The Office of Chief Auditor may wish to establish a consistent approach to implementing changes to the Web site to enhance accountability and timeliness. As the Board establishes more standards and rules and if it adopts a new codification framework, maintaining the Web site will become even more important.

The full report included recommendations intended to assist the Office of Chief Auditor as it continues to establish its internal processes. The Chief Auditor concurred with these recommendations.