

File No. PCAOB-2006-03  
Consists of 26 Pages

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

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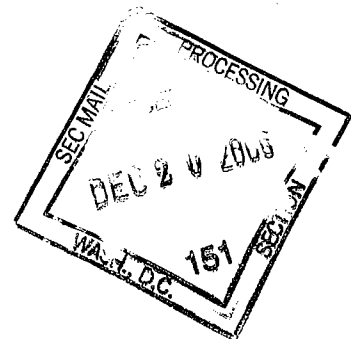
Form 19b-4

Proposed Rule Change

By

Public Company Accounting Oversight Board

In accordance with Rule 19b-4 under the  
Securities Exchange Act of 1934



1. Text of the Proposed Rule

(a) Pursuant to the provisions of Section 107(b) of the Sarbanes-Oxley Act of 2002 (the "Act"), the Public Company Accounting Oversight Board (the "Board" or the "PCAOB") is filing with the Securities and Exchange Commission ("SEC" or "Commission") proposed rules consisting of amendments to the Board's Rules on Inspections. The proposed rules are attached as Exhibit A.

(b) The proposed rules will have a direct effect on three existing rules by amending them: PCAOB Rule 4003, Frequency of Inspections; PCAOB Rule 4006, Duty to Cooperate with Inspectors; and PCAOB Rule 4009, Firm Response to Quality Control Defects.

(c) All three rules identified in (b) above were addressed in PCAOB-2003-08, filed in accordance with Rule 19b-4 under the Securities Exchange Act of 1934 on October 7, 2003.

2. Procedures of the Board

(a) The Board approved Rule 4003(d) and the amendments to Rules 4006 and 4009(d)(2) at a meeting on December 19, 2006. No other action by the Board is necessary for the filing of the proposed rule change.

(b) Questions regarding this rule filing may be directed to Gordon Seymour, Deputy General Counsel (202-207-9034; [seymourg@pcaobus.org](mailto:seymourg@pcaobus.org)) or Michael Stevenson, Senior Associate General Counsel (202-207-9054; [stevensonm@pcaobus.org](mailto:stevensonm@pcaobus.org)).

3. Board's Statement of the Purpose of, and the Statutory Basis for, the Proposed Rules

(a) Purpose

Section 104 of the Act requires the Board to conduct a continuing program of inspections to assess the degree of compliance of each registered public accounting firm and associated persons of that firm with the Act, the rules of the Board, the rules of the Commission, or professional standards, in connection with its performance of audits, issuance of audit reports, and related matters involving issuers. The Board has adopted an amendment to its Rule 4003 to temporarily adjust minimum inspection frequency requirement applicable to certain firms. The Board has adopted technical amendments to its Rules 4006 and 4009 to correct non-substantive points.

(b) Statutory Basis

The statutory basis for the proposed rule change is Title I of the Act.

4. Board's Statement on Burden on Competition

The Board does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. With respect to the firms subject to an inspection requirement, the proposed rules impose no burden beyond the burdens clearly imposed and contemplated by the Act, and the proposed rules do not change the obligations of those firms as already set out in the Act and in existing Board rules.

5. Board's Statement on Comments on the Proposed Rule Received from Members, Participants or Others

The Board did not solicit or receive comments before adopting the proposed rules.

6. Extension of Time Period for Commission Action

The Board does not consent to an extension of the time period specified in Section 19(b)(2) of the Securities Exchange Act of 1934.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2) of the Securities Exchange Act

Pursuant to Section 19(b)(2) of the Exchange Act, the Board requests accelerated effectiveness for the proposed amendments. Good cause exists for accelerated effectiveness.

Rule 4003(d) involves a temporary adjustment, for administrative and programmatic reasons, to an existing rule to which the Board is not making any permanent change. The proposed rule does not in any way affect the rights or obligations, under the Board's rules, of registered public accounting firms or persons associated with those firms. The proposed rule merely facilitates temporary flexibility in Board inspection planning in furtherance of the long-term objective of establishing an inspection program that, from year-to-year, makes relatively constant resource demands and inspects a relatively constant mix of types of registered firms. The Board has budgeted and planned its 2007 inspections, as well as allocated its inspection resources in 2006, in a manner consistent with Rule 4003(d). Granting accelerated effectiveness to the rule would not affect the rights or obligations of other persons. In addition, the Board has invited public comment on Rule 4003(d) and has set a June 30,

2007 expiration date for Rule 4003(d) unless the Board acts to extend the rule. This Board process ensures that public comment will be taken into account, and the Board will separately act, and seek Commission approval of any separate action, to extend the rule's effectiveness beyond June 30, 2007.

The technical amendment to Rule 4006 merely changes paragraph numbering from "(1)" and "(2)" to "(a)" and "(b)" to conform to the convention in the Board's rules generally. The technical amendment to Rule 4009(d)(2) changes a cross-reference to "paragraph (b) of this rule" to a cross-reference to "paragraph (c)" to correct an error generated when the paragraph numbering, but not the cross-reference, changed between the text of the rule as originally proposed and the text of the rule as later adopted. These technical amendments do not affect the rights or obligations of any person.

8. Proposed Rules Based on Rules of Another Board or of the Commission

Not applicable.

9. Exhibits

Exhibit A – Text of Proposed Rules

Exhibit 1 – Form of Notice of Proposed Rule for Publication in the Federal Register.

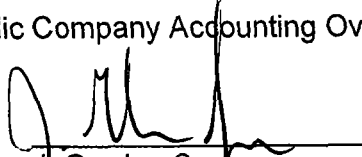
Exhibit 2 – PCAOB Release No. 2006-008 (December 19, 2006)

10. Signatures

Pursuant to the requirements of the Act and the Securities Exchange Act of 1934, as amended, the Board has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

Public Company Accounting Oversight Board

By:



J. Gordon Seymour  
Deputy General Counsel  
and Secretary



## Exhibit A – Text of Proposed Rules

The Board has amended Section 4 of its rules by adding a new paragraph (paragraph (d)) to Rule 4003, by revising the numbering of the paragraphs in Rule 4006 from "(1)" and "(2)" to "(a)" and "(b)," and by correcting a cross-reference in Rule 4009(d)(2). The relevant portions of the Rules, as amended, are set out below. Language added by these amendments is underlined. Deleted paragraph references are in brackets. Other text in Section 4, including notes to the Rules, remains unchanged and is indicated by " \* \* \* " in the text below.

### RULES OF THE BOARD

\* \* \*

#### SECTION 4. INSPECTIONS

\* \* \*

##### **Rule 4003. Frequency of Inspections**

\* \* \*

(d) Notwithstanding paragraph (b) of this Rule, with respect to any registered public accounting firm that became registered in 2003 or 2004 –

(1) this Rule does not require the first inspection of the firm sooner than the fourth calendar year following the first calendar year in which the firm, while registered, issued an audit report or played a substantial role in the preparation or furnishing of an audit report; and

(2) this Rule does not require the second inspection of the firm sooner than the fifth calendar year following the first calendar year in which the firm, while registered, issued an audit report or played a substantial role in the preparation or furnishing of an audit report.

\* \* \*

**Rule 4006. Duty to Cooperate with Inspectors**

Every registered public accounting firm, and every associated person of a registered public accounting firm, shall cooperate with the Board in the performance of any Board inspection. Cooperation shall include, but is not limited to, cooperating and complying with any request, made in furtherance of the Board's authority and responsibilities under the Act, to –

(1)a provide access to, and the ability to copy, any record in the possession, custody, or control of such firm or person, and

(2)b provide information by oral interviews, written responses, or otherwise.

\* \* \*

**Rule 4009. Firm Response to Quality Control Defects**

\* \* \*

(d) The portions of the Board's inspection report that deal with criticisms of or potential defects in quality control systems that the firm has not addressed to the satisfaction of the Board shall be made public by the Board –

\* \* \*

(2) upon the expiration of the period in which the firm may seek Commission review of any Board determination made under paragraph (b)c of this rule, if the firm does not seek Commission review of the Board determination;

\* \* \*



EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34- ; File No. PCAOB-2006-03)

[Date]

Public Company Accounting Oversight Board; Notice of Filing and Accelerated Effectiveness of Proposed Amendments to Board Rules Relating to Inspections

Pursuant to Section 107(b) of the Sarbanes-Oxley Act of 2002 (the "Act"), notice is hereby given that on December 20, 2006, the Public Company Accounting Oversight Board (the "Board" or the "PCAOB") filed with the Securities and Exchange Commission (the "SEC" or "Commission") the proposed rule changes described in Items I, II, and III below, which items have been prepared by the Board. The Commission is publishing this notice to solicit comments on the proposed rule from interested persons.

I. Board's Statement of the Terms of Substance of the Proposed Rule

On December 19, 2006, the Board adopted amendments to its rules related to inspections. The proposed amendments include a new paragraph (d) added to existing Rule 4003 and include technical amendments to nonsubstantive points in existing rules 4006 and 4009. The text of the proposed amendments are set out below. Language added by these amendments is underlined. Deleted paragraph references are in brackets. Other text in Section 4 of the Board's Rules, including notes to the Rules, remains unchanged and is indicated by " \* \* \* " in the text below.

#### SECTION 4. INSPECTIONS

\* \* \*

**Rule 4003. Frequency of Inspections**

\* \* \*

(d) Notwithstanding paragraph (b) of this Rule, with respect to any registered public accounting firm that became registered in 2003 or 2004 –

(1) this Rule does not require the first inspection of the firm sooner than the fourth calendar year following the first calendar year in which the firm, while registered, issued an audit report or played a substantial role in the preparation or furnishing of an audit report; and

(2) this Rule does not require the second inspection of the firm sooner than the fifth calendar year following the first calendar year in which the firm, while registered, issued an audit report or played a substantial role in the preparation or furnishing of an audit report.

\* \* \*

**Rule 4006. Duty to Cooperate with Inspectors**

Every registered public accounting firm, and every associated person of a registered public accounting firm, shall cooperate with the Board in the performance of any Board inspection. Cooperation shall include, but is not limited to, cooperating and complying with any request, made in furtherance of the Board's authority and responsibilities under the Act, to –

([1]a) provide access to, and the ability to copy, any record in the possession, custody, or control of such firm or person, and

([2]b) provide information by oral interviews, written responses, or otherwise.

\* \* \*

**Rule 4009. Firm Response to Quality Control Defects**

\* \* \*

(d) The portions of the Board's inspection report that deal with criticisms of or potential defects in quality control systems that the firm has not addressed to the satisfaction of the Board shall be made public by the Board –

\* \* \*

(2) upon the expiration of the period in which the firm may seek Commission review of any Board determination made under paragraph ([b]c) of this rule, if the firm does not seek Commission review of the Board determination;

\* \* \*

II. Board's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule

In its filing with the Commission, the Board included statements concerning the purpose of, and basis for, the proposed rule. The text of these statements may be examined at the places specified in Item IV below. The Board has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Board's Statement of the Purpose Of, and Statutory Basis for, the Proposed Rule

(a) Purpose

Section 104 of the Act requires the Board to conduct a continuing program of inspections to assess the degree of compliance of each registered public accounting firm and associated persons of that firm with the Act, the rules of the Board, the rules of the Commission, or professional standards, in connection with its performance of audits, issuance of audit reports, and related matters involving issuers. The Board has adopted an amendment to its Rule 4003 to temporarily adjust minimum inspection frequency requirement applicable to certain firms. The Board has adopted technical amendments to its Rules 4006 and 4009 to correct non-substantive points. The proposed amendments are discussed below.

Section 104(b)(1)(B) of the Act requires the Board to conduct an inspection, at least once every three years, of each registered firm that regularly provides audit

reports for 100 or fewer issuers, and Section 104(b)(2) of the Act authorizes the Board to adopt rules adjusting that frequency. In 2003, the Board adopted Rule 4003(b), which provides that the Board will conduct inspections, on a triennial basis, not only of each firm that regularly provides audit reports for 100 or fewer issuers, but also of any firm that issues any audit report or that play a substantial role in the preparation or furnishing of an audit report.

In the course of inspection planning, including in connection with the Board's budget process, the Board identified a way in which a temporary adjustment to Rule 4003 would, over time, maximize the Board's ability to allocate its inspection resources more evenly, consistently, and effectively year-to-year. The issue arises because the first three years of inspections, 2004 to 2006, coincided with the Board's initial growth period and, as a consequence, the resources available for and devoted to the inspections of firms with 100 or fewer issuer audit clients increased from year to year. The resources available in each year necessarily informed the extent of the inspection work performed in that year, including with respect to both the numbers of firms inspected and the size of firms inspected.<sup>1/</sup> This resulted in a year-to-year fluctuation that, because of the minimum frequency requirements of Rule 4003(b), the Board would to some extent be locked into repeating in succeeding three-year periods.

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<sup>1/</sup> In 2004, the Board inspected 91 firms with 100 or fewer issuer audit clients. In 2005, the Board inspected 272 such firms. In 2006, the Board expects to inspect approximately 163 such firms. Because variations in the nature and size of firms' audit practices result in different inspection resource requirements, mere comparison of the numbers of inspected firms does not reflect fully the related resource issues.

To avoid that consequence, the Board is adding to Rule 4003 a new paragraph that will temporarily adjust aspects of the inspection cycle requirement. Paragraph (d) will allow the Board to approach long-term inspection planning with the flexibility to eliminate the fluctuation generated in the start-up cycle, including the flexibility to make adjustments that will result in a relatively consistent, from year to year, mix of firms in terms of the size and nature of audit practice.<sup>2/</sup> Paragraph (d) accomplishes that result by providing that, with respect to firms that became registered in 2003 or 2004,<sup>3/</sup> (1) the Board need not conduct the firm's first inspection sooner than the fourth year after the firm, while registered, first issues an audit report or plays a substantial role, and (2) the Board need not conduct the firm's second inspection sooner than the fifth year after the firm, while registered, first issues an audit report or plays a substantial role.

Even with this adjustment, the Board expects that each U.S. firm that issued an original audit report (as distinct from a consent to use a previously issued audit report) in 2003 or 2004 after registering with the Board will have its first inspection within the three-year period after first issuing an original audit report. The flexibility provided by the adjustment would come into play principally with respect to the timing of the second

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<sup>2/</sup> This point should not be understood to suggest that the Board envisions rigid adherence to a fixed triennial inspection schedule for each firm once a particular year-to-year mix of firms is established. For a variety of reasons – including to address specific risks or to enhance the value of the inspection process by reducing the predictability of the timing of any firm's next inspection – the Board may sometimes inspect a firm sooner than three years after the firm's previous inspection.

<sup>3/</sup> On October 22, 2003, it became unlawful for any U.S. public accounting firm to issue, or to play a substantial role in the preparation or furnishing of, an audit report with respect to any issuer unless the firm was registered with the Board. The same registration requirement took effect for non-U.S. firms on July 19, 2004. See Section 102(a) of the Act and PCAOB Rule 2100.

inspection of some of those firms, the timing of the first two inspections of some non-U.S. firms, and the timing of inspections of firms that play a substantial role but do not issue audit reports. The adjustment would have no continuing effect on the timing of any inspections after the second inspections of firms that registered in 2003 and 2004, and would have no effect on the timing of any inspection of any firm that registered after 2004.

It is important to note that Rule 4003 does not limit the Board's authority to conduct inspections at any time, and that registered firms' own obligations are not affected by Rule 4003 or the amendment. Rule 4003 establishes a minimum inspection frequency governing how the Board carries out its inspection program. Rule 4003 does not preclude the Board from inspecting any firm more frequently than the schedule set out in the rule. A firm's obligation is to cooperate in any Board inspection at any time that the Board determines to inspect the firm, regardless of the provisions of Rule 4003.

The temporary adjustment to the inspection frequency requirement is consistent with the purposes of the Act, the public interest, and the protection of investors. The adjustment will facilitate the reduction of certain year-to-year fluctuations in the inspection program, which otherwise could interfere with the Board's ability to implement a program consistently and effectively with relatively stable resources from year to year. The adjustment will accomplish this while delaying only a relatively small portion of inspections, and delaying them only for a short period.

The Board adopted Rule 4003(d) before obtaining public comment because of the nature of the rule, which involves a temporary adjustment, for administrative and programmatic reasons, to an element of an existing rule to which the Board is not

making any permanent change. Nevertheless, the Board has invited public comment on Rule 4003(d), and the Board has provided that Rule 4003(d) will expire on June 30, 2007 unless the Board, after considering any public comment, acts to adopt the rule for a longer period.

The Board has also adopted technical amendments to two aspects of the rules relating to inspections. In Rule 4006, the Board is revising the numbering of the paragraphs from "(1)" and "(2)" to "(a)" and "(b)" to conform to the convention in the Board's rules generally. In Rule 4009(d)(2), the Board is correcting a cross-reference. Rule 4009(d)(2)'s cross-reference to "paragraph (b) of this rule" dates to the Board's originally proposed Rule 4009. The substance of paragraph (b) in the proposed rule was moved to paragraph (c) in the final rule adopted by the Board, and the cross-reference in paragraph (d)(2) should have been revised to cross-reference paragraph (c) at that time. The Board has now corrected that cross-reference.

(b) Statutory Basis

The statutory basis for the proposed rule is Title I of the Act.

B. Board's Statement on Burden on Competition

The Board does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. With respect to the firms subject to an inspection requirement, the proposed rules impose no burden beyond the burdens clearly imposed and contemplated by the Act, and the proposed rules do not change the obligations of those firms as already set out in the Act and in existing Board rules.

C. Board's Statement on Comments on the Proposed Rule Received from Members, Participants or Others

The Board did not solicit or receive comments before adopting the proposed rules.

III. Date of Effectiveness of the Proposed Rule and Timing for Commission Action

Within 35 days of the date of publication of this notice in the *Federal Register* or within such longer period as (i) the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule is consistent with the requirements of Title I of the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule that are filed with the Commission, and all written communications relating to the proposed rule between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for



inspection and copying at the principal office of the PCAOB. All submissions should refer to File No. PCAOB-2006-02 and should be submitted within [ ] days.

By the Commission.

Secretary



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AMENDMENTS TO  
BOARD RULES RELATING  
TO INSPECTIONS

PCAOB Release No. 2006-008  
December 19, 2006  
  
PCAOB Rulemaking  
Docket Matter No. 022

Summary: The Public Company Accounting Oversight Board ("Board" or "PCAOB") is adopting an amendment to Rule 4003 to make a temporary adjustment to inspection frequency requirements. The amendment will expire on June 30, 2007, unless the Board acts to extend it. The Board is also adopting technical amendments to Rules 4006 and 4009 to correct a numbering error and an erroneous cross-reference. The amendments will take effect upon approval by the Securities and Exchange Commission ("Commission").

Public Comments: Although the Board is adopting the amendment to Rule 4003 as a final rule, the Board invites public comment, and the Board will consider any comments in determining whether to extend the amendment beyond June 30, 2007. Interested persons may submit written comments by sending them to the Office of the Secretary, PCAOB, 1666 K Street, N.W., Washington, DC 20006. Comments also may be submitted by e-mail to [comments@pcaobus.org](mailto:comments@pcaobus.org). All comments should refer to PCAOB Rulemaking Docket Matter No. 022 in the subject or reference line and should be received by the Board no later than 5:00 p.m. (EST) on February 16, 2007. Because of the nature of the technical amendments to Rules 4006 and 4009, the Board is adopting them without seeking public comment.

Board Contacts: Michael Stevenson, Senior Associate General Counsel (202-207-9054; [stevensonm@pcaobus.org](mailto:stevensonm@pcaobus.org)), and, for questions relating to non-U.S. firms, Rhonda Schnare, Director of International Affairs (202-207-9167; [schnarer@pcaobus.org](mailto:schnarer@pcaobus.org)).



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### I. Background

Section 104(a) of the Sarbanes-Oxley Act of 2002 ("the Act") requires the Board to conduct a continuing program of inspections of registered public accounting firms. Section 104(b)(1)(B) of the Act provides that, with respect to each registered public accounting firm that regularly provides audit reports for 100 or fewer issuers, the Board shall conduct an inspection "not less frequently than once every 3 years." Section 104(b)(2) of the Act authorizes the Board to adjust that inspection frequency by rule if the Board finds that a different inspection schedule is consistent with the purposes of the Act, the public interest, and the protection of investors.

In 2003, the Board adopted PCAOB Rule 4003, "Frequency of Inspections." Rule 4003(b) provides that any registered firm that issues, or plays a substantial role in preparing or furnishing, an audit report for at least one issuer, but no more than 100 issuers, shall be inspected "at least once in every three calendar years."<sup>1/</sup> Rule 4003(b) goes beyond what the Act requires in two ways. First, the rule's scope is not limited, as the Act's is, to firms that "regularly provide" audit reports, but also includes, at least for one cycle, any registered firm that issues a single audit report while registered. Second, the rule's scope is not limited, as the Act's is, to firms that provide audit reports, but also includes any firm that plays a substantial role in the preparation or furnishing of an audit report, even if the firm does not issue an audit report.

The end of 2006 will mark the end of the first three-year cycle for a large number of firms.<sup>2/</sup> The Board expects to end 2006 having inspected (1) all of the

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<sup>1/</sup> Section 104(b)(1)(A) of the Act and PCAOB Rule 4003(a) require annual inspections of registered firms that regularly provide audit reports for more than 100 issuers. The amendment to Rule 4003 that the Board is adopting does not affect the inspection frequency requirement for those firms.

<sup>2/</sup> The three-year minimum frequency is firm-specific and begins in the calendar year following any year in which a registered firm issues, or plays a substantial role in the preparation or furnishing of, an audit report with respect to an issuer. Many registered firms have not issued an audit report, or played a substantial role, since becoming registered, and neither the Act nor the Board's rules require the inspection of those firms. In addition, any firm that registered after 2003, or that registered in 2003 but did not issue an audit report or play a substantial role in 2003 while registered, would not be in a 2004-2006 inspection cycle. The cycle for any such firm would begin the year after the firm first issued an audit report or played a substantial role while registered.



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firms that, under the criteria set out in the Act, were required to be inspected in the 2004-2006 cycle, (2) all but 19 of the firms that fell into a 2004-2006 cycle by virtue of Rule 4003(b),<sup>3/</sup> and (3) more than 300 additional firms that will have had their first inspection even though the first three-year cycle applicable to them does not end until 2007 or later. In all, by the end of 2006, the Board will have inspected more than 520 firms with 100 or fewer issuer audit clients.<sup>4/</sup>

### II. The Amendment to Rule 4003

In the course of inspection planning, including in connection with the Board's budget process, the Board has identified a way in which a temporary adjustment to Rule 4003 would, over time, maximize the Board's ability to allocate its inspection resources more evenly, consistently, and effectively year-to-year. The issue arises because the first three years of inspections, 2004 to 2006, coincided with the Board's initial growth period and, as a consequence, the resources available for and devoted to the inspections of firms with 100 or fewer issuer audit clients increased from year to year. The resources available in each year necessarily informed the extent of the inspection work performed in that year, including with respect to both the numbers of firms inspected and the size of firms inspected.<sup>5/</sup> This resulted in a year-to-year fluctuation that, because of the minimum frequency requirements of Rule 4003(b), the Board would to some extent be locked into repeating in succeeding three-year periods.

To avoid that consequence, the Board is adding to Rule 4003 a new paragraph that will temporarily adjust aspects of the inspection cycle requirement. Paragraph (d) will allow the Board to approach long-term inspection planning with the flexibility to eliminate the fluctuation generated in the start-up cycle, including the flexibility to make adjustments that will result in a

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<sup>3/</sup> Section III, below, discusses the circumstances concerning the 19 firms not being inspected by the end of 2006.

<sup>4/</sup> In 2004 and 2005, combined, the Board inspected a total of 363 such firms. As of the date of this Release, the Board has inspected, or is inspecting, 163 such firms in 2006.

<sup>5/</sup> In 2004, the Board inspected 91 firms with 100 or fewer issuer audit clients. In 2005, the Board inspected 272 such firms. In 2006, the Board expects to inspect approximately 163 such firms. Because variations in the nature and size of firms' audit practices result in different inspection resource requirements, mere comparison of the numbers of inspected firms does not reflect fully the related resource issues.



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relatively consistent, from year to year, mix of firms in terms of the size and nature of audit practice.<sup>6/</sup> Paragraph (d) accomplishes that result by providing that, with respect to firms that became registered in 2003 or 2004,<sup>7/</sup> (1) the Board need not conduct the firm's first inspection sooner than the fourth year after the firm, while registered, first issues an audit report or plays a substantial role, and (2) the Board need not conduct the firm's second inspection sooner than the fifth year after the firm, while registered, first issues an audit report or plays a substantial role.

Even with this adjustment, the Board expects that each U.S. firm that issued an original audit report (as distinct from a consent to use a previously issued audit report) in 2003 or 2004 after registering with the Board will have its first inspection within the three-year period after first issuing an original audit report. The flexibility provided by the adjustment would come into play principally with respect to the timing of the second inspection of some of those firms, the timing of the first two inspections of some non-U.S. firms, and the timing of inspections of firms that play a substantial role but do not issue audit reports.<sup>8/</sup> The adjustment would have no continuing effect on the timing of any inspections after the second inspections of firms that registered in 2003 and 2004, and would have no effect on the timing of any inspection of any firm that registered after 2004.

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<sup>6/</sup> This point should not be understood to suggest that the Board envisions rigid adherence to a fixed triennial inspection schedule for each firm once a particular year-to-year mix of firms is established. For a variety of reasons – including to address specific risks or to enhance the value of the inspection process by reducing the predictability of the timing of any firm's next inspection – the Board may sometimes inspect a firm sooner than three years after the firm's previous inspection.

<sup>7/</sup> On October 22, 2003, it became unlawful for any U.S. public accounting firm to issue, or to play a substantial role in the preparation or furnishing of, an audit report with respect to any issuer unless the firm was registered with the Board. The same registration requirement took effect for non-U.S. firms on July 19, 2004. See Section 102(a) of the Act and PCAOB Rule 2100.

<sup>8/</sup> As discussed in Section III below, the Board is separately considering whether to eliminate Rule 4003(b)'s provision for regular, periodic inspections of firms that play a substantial role in audits but that do not issue audit reports. The Board would not eliminate that provision, however, before seeking and considering public comment on the issue.



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It is important to note that Rule 4003 does not limit the Board's authority to conduct inspections at any time, and that registered firms' own obligations are not affected by Rule 4003 or the amendment. Rule 4003 establishes a minimum inspection frequency governing how the Board carries out its inspection program. Rule 4003 does not preclude the Board from inspecting any firm more frequently than the schedule set out in the rule. A firm's obligation is to cooperate in any Board inspection at any time that the Board determines to inspect the firm, regardless of the provisions of Rule 4003.

The temporary adjustment to the inspection frequency requirement is consistent with the purposes of the Act, the public interest, and the protection of investors. The adjustment will facilitate the reduction of certain year-to-year fluctuations in the inspection program, which otherwise could interfere with the Board's ability to implement a program consistently and effectively with relatively stable resources from year to year. The adjustment will accomplish this while delaying only a relatively small portion of inspections, and delaying them only for a short period.

### III. Relationship to the 2006 Inspection Schedule

The reasons for the temporary adjustment are those described above, relating to the desirability of organizing the future allocation of inspection resources in a certain way. In anticipation of making this adjustment, however, the Board factored the flexibility provided by the amendment into its 2007 budget and inspection planning and also postponed the inspection of 19 firms that fell into the 2004-2006 cycle under the existing rule. Those 19 firms fall into two categories, described below. In light of the circumstances described below, the Board focused 2006 inspection resources on the inspections of other firms – including more than 60 firms that are in an initial inspection cycle that does not end until 2007 or later – rather than inspect these 19 firms in 2006:

- Eleven U.S. firms triggered their inclusion in the 2004-2006 inspection cycle solely by virtue of providing an audit client with a consent to use an audit report that the firm had issued at a time before registration with the Board was required (and nine of those firms have not issued any original audit reports since becoming registered).
- Eight other U.S. firms triggered their inclusion in the 2004-2006 cycle solely by playing a substantial role in the preparation or furnishing of an audit report (and seven of those firms have not issued any audit reports since becoming registered). The Board is separately considering a possible amendment to Rule 4003 that would eliminate the rule's requirement (which is not in the Act) for regular periodic inspection of firms



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that play a substantial role but do not issue audit reports. The Board would not adopt any such amendment without first seeking public comment, and, in the absence of such an amendment, these eight firms will be inspected in 2007. In light of the possibility of such an amendment, however, the Board has focused 2006 inspection resources on firms that serve as principal auditors.

### IV. Other Technical Amendments

The Board has also adopted technical amendments to two aspects of the rules relating to inspections. In Rule 4006, the Board is revising the numbering of the paragraphs from "(1)" and "(2)" to "(a)" and "(b)" to conform to the convention in the Board's rules generally. In Rule 4009(d)(2), the Board is correcting a cross-reference. Rule 4009(d)(2)'s cross-reference to "paragraph (b) of this rule" dates to the Board's originally proposed Rule 4009. The substance of paragraph (b) in the proposed rule was moved to paragraph (c) in the final rule adopted by the Board, and the cross-reference in paragraph (d)(2) should have been revised to cross-reference paragraph (c) at that time. The Board has now corrected that cross-reference.

### V. Effective Date, Expiration Date, and Opportunity for Public Comment

The Board is adopting Rule 4003(d) as a final rule to take effect upon Commission approval. Rule 4003(d) will expire on June 30, 2007 unless the Board acts to extend it or, before that date, acts to abrogate it.

The Board is adopting Rule 4003(d) before obtaining public comment because of the nature of the rule, which involves a temporary adjustment, for administrative and programmatic reasons, to an element of an existing rule to which the Board is not making any permanent change. The Board has budgeted and planned its 2007 inspections, as well as allocated its inspection resources in 2006, in a manner consistent with Rule 4003(d). Nevertheless, the Board invites public comment on Rule 4003(d), and the Board has included the June 30, 2007 sunset date to ensure that the Board will need to act again, after receiving comment, before giving Rule 4003(d) any longer period of effectiveness. If Rule 4003(d) should expire on, or be abrogated before, June 30, 2007, the Board will adjust its inspection planning going forward to comport with existing Rule 4003(b).

Interested persons may submit written comments on Rule 4003(d) by sending them to the Office of the Secretary, PCAOB, 1666 K Street, N.W., Washington, DC 20006. Comments also may be submitted by e-mail to [comments@pcaobus.org](mailto:comments@pcaobus.org). All comments should refer to PCAOB Rulemaking



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Docket Matter No. 022 in the subject or reference line and should be received by the Board no later than 5:00 p.m. (EST) on February 16, 2007.

Because of the nature of the technical amendments to Rules 4006 and 4009, the Board is adopting them as final rules, and they will be effective upon Commission approval. The Board is not seeking public comment on these amendments.

\* \* \*

On the 19th day of December, in the year 2006, the foregoing was, in accordance with the bylaws of the Public Company Accounting Oversight Board,

ADOPTED BY THE BOARD.

/s/ J. Gordon Seymour

J. Gordon Seymour  
Secretary

December 19, 2006

APPENDIX –  
Amendments to PCAOB Rules 4003, 4006, and 4009





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### Appendix – Amendments to Rules Relating to Inspections

The Board has amended Section 4 of its rules by adding a new paragraph (paragraph (d)) to Rule 4003, by revising the numbering of the paragraphs in Rule 4006 from "(1)" and "(2)" to "(a)" and "(b)," and by correcting a cross-reference in Rule 4009(d)(2). The relevant portions of the Rules, as amended, are set out below. Language added by these amendments is shown in bold italics. Deleted paragraph references are struck through. Other text in Section 4, including notes to the Rules, remains unchanged and is indicated by " \* \* \* " in the text below.

## RULES OF THE BOARD

\* \* \*

### SECTION 4. INSPECTIONS

\* \* \*

#### Rule 4003. Frequency of Inspections

\* \* \*

*(d) Notwithstanding paragraph (b) of this Rule, with respect to any registered public accounting firm that became registered in 2003 or 2004 –*

*(1) this Rule does not require the first inspection of the firm sooner than the fourth calendar year following the first calendar year in which the firm, while registered, issued an audit report or played a substantial role in the preparation or furnishing of an audit report; and*

*(2) this Rule does not require the second inspection of the firm sooner than the fifth calendar year following the first calendar year in which the firm, while registered, issued an audit report or played a substantial role in the preparation or furnishing of an audit report.*

\* \* \*



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### Rule 4006. Duty to Cooperate with Inspectors

Every registered public accounting firm, and every associated person of a registered public accounting firm, shall cooperate with the Board in the performance of any Board inspection. Cooperation shall include, but is not limited to, cooperating and complying with any request, made in furtherance of the Board's authority and responsibilities under the Act, to –

(1a) provide access to, and the ability to copy, any record in the possession, custody, or control of such firm or person, and

(2b) provide information by oral interviews, written responses, or otherwise.

\*\*\*

### Rule 4009. Firm Response to Quality Control Defects

\*\*\*

(d) The portions of the Board's inspection report that deal with criticisms of or potential defects in quality control systems that the firm has not addressed to the satisfaction of the Board shall be made public by the Board –

\*\*\*

(2) upon the expiration of the period in which the firm may seek Commission review of any Board determination made under paragraph (bc) of this rule, if the firm does not seek Commission review of the Board determination;

\*\*\*