

# PCAOB

Public Company Accounting Oversight Board

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May 16, 2005

The Honorable Paul S. Atkins  
Commissioner  
U.S. Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, DC 20549

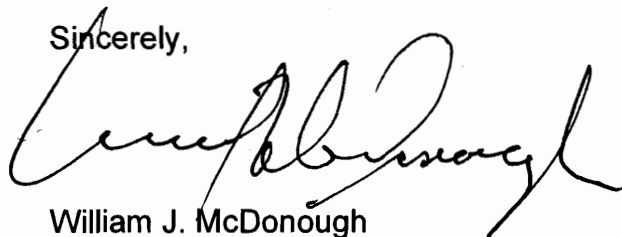
Dear Commissioner Atkins:

Thank you for your March 11, 2005, letter concerning the Public Company Accounting Oversight Board's 2005 budget. We received your letter on March 18, 2005, and I asked the PCAOB staff to prepare written responses to your questions. The responses are attached.

We were pleased to have the opportunity to discuss the PCAOB's operations and budget submission when you and your staff visited the PCAOB's offices on February 18, 2005.

If you have further questions or I can be of any other assistance, please do not hesitate to contact me.

Sincerely,





William J. McDonough

cc. The Hon. William H. Donaldson  
Chairman, Securities and Exchange Commission

**MAY 18 2005**

## MEMORANDUM

**To:** Chairman McDonough

**From:** The Office of the Chief Administrative Officer   
The Office of the General Counsel 

**Subject:** Responses to Questions posed by Commissioner Atkins

**Date:** May 16, 2005

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You have asked us to prepare responses to certain questions posed by Commission Atkins. We have done so, and the responses, along with Commissioner Atkins' questions, are presented below.

By way of background, the Board submitted its original 2005 budget to the Commission for approval on October 26, 2004, and its revised budget on January 6, 2005. In the following months, we met with the SEC staff on numerous occasions, both at our offices and at the Commission, provided access to requested documents, and submitted a number of prepared schedules and other documents to the SEC staff to supplement and further explain the PCAOB's budget submission.

**1. What is the optimal size of the PCAOB? Will it continue to grow or do you expect it to shrink?**

In the near term, the 2005 budget anticipates that the organization will continue to aggressively recruit throughout the year, especially new inspectors, resulting in a total headcount of 452 by the end of 2005. As reflected in the SEC's Order approving the PCAOB's budget,<sup>1/</sup> the PCAOB plans during 2005 to undertake a long-range strategic planning initiative for its operations and budget. This process should allow the organization to better define its expected size once it matures. This strategic planning will take into account, among other factors, the Board's obligations under the Sarbanes-Oxley Act of 2002, including the requirement in Section 104 that the Board inspect every registered public accounting firm with at least one issuer audit client every three years, and those registered firms with more than 100 issuer audit clients each year.

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<sup>1/</sup> Order Approving Public Company Accounting Oversight Board Revised Budget and Annual Accounting Support Fee for Calendar Year 2005, Securities Exchange Act Rel. No. 34-51313 (March 3, 2005).

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- 2. It is my understanding that SEC staff salaries are all public. Are the PCAOB staff salaries public? If not, should they be? What is the average salary of the PCAOB staff? What is the average salary of the PCAOB's professional staff?**

While the Board did make a general salary schedule available at its first open meeting in January 2003 and the amount of its Board members' salaries is publicly available, like other non-governmental organizations, it does not disclose its employees' salaries, for both competitive and privacy reasons. For 2004, the average salary for PCAOB professional staff was \$168,180. For 2005, this number is projected to be \$165,468. The average salary for all staff for 2004 was \$159,748; that number is projected to be \$154,652 for 2005. The expected decrease is due to our plan to hire additional staff that have, on average, less experience than staff already hired.

- 3. What is the average cost per PCAOB employee (salary and benefits)?**

The average salary and benefit cost per PCAOB employee was \$178,000 for 2004.

- 4. What is the turnover rate at the PCAOB? It is hiring, but is its staff size actually getting bigger? How large was its professional staff last year and how large is it currently?**

While it is difficult to calculate and provide a meaningful turn over rate in an organization such as the PCAOB that is still in a growth stage, we can say that hiring continues to well out-pace attrition. During 2003, the Board hired 126 employees and lost four. During 2004, the Board hired 136 and lost 25. The number of professional staff, depending on how you define that term, at December 31, 2004, was approximately 220; that number is now approximately 270.

- 5. There appear to be three main groups at the PCAOB – the standards setting group, the inspections group, and the enforcement group. Where is the PCAOB budgeting most of its additional hiring?**

The majority of the Board's new hires are expected to be experienced accountants needed to conduct inspections of registered public accounting firms. The Board intends to hire roughly 85 inspectors during the remainder of 2005, increasing the inspections staff from 138 to 219 by year-end.

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6. **Does the PCAOB have enough personnel to provide interpretations and practice tools for outside professionals to use as they try to implement new standards set by the PCAOB? This type of guidance is especially useful for firms that do not have the same resources as the Big Four firms.**

The 2005 budget allows the PCAOB to continue to develop and issue rules, standards and related guidance on auditing and related attestations, quality control, ethics and independence for public company auditors to use. This includes the hiring of four more professional staff in the Office of Chief Auditor. In addition, the PCAOB will continue to utilize current staff and resources to assist practitioners in the understanding and implementation of the Board's standards. For example, the 2005 budget reflects the PCAOB's plans to continue its series of small business forums throughout the country, where registered public accounting firms and public companies in the small business community have the opportunity to learn more about the PCAOB, specifically the PCAOB inspections process and the impact of new auditing standards. In addition, the staff has and will continue to issue responses to frequently asked questions, which are posted on the PCAOB's Web site.

7. **How has the PCAOB staffed up to deal with international issues? What are its objectives and goals in this area?**

The PCAOB's efforts on the international front have been spearheaded by Chairman McDonough. In support of the Chairman's efforts, the PCAOB currently has two professional and one support staff devoted to international initiatives, with the addition of two professional staff budgeted for 2005. In addition, currently two professional staff within the Board's Division of Registration and Inspections concentrate on international matters.

The Board's objectives in this area were defined in Section 106(a) of the Act. That section provides that any non-U.S. public accounting firm that prepares or furnishes an audit report with respect to any U.S. public company is subject to the Act and the rules of the Board and the Commission issued under the Act, in the same manner and to the same extent as a public accounting firm that is organized and operates under the laws of any state of the United States. The Board has attempted to build a framework within which the Act's requirements may be fulfilled while recognizing the special concerns that attach to the regulation of non-U.S. firms. As part of these efforts, the Board has been engaged in a constructive dialogue with many of its foreign counterparts concerning reforms in the oversight of auditing firms that audit companies whose securities trade in public markets and the possible development of a cooperative

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arrangement for such oversight. This dialogue has demonstrated that the Board and its foreign counterparts share many of the same objectives. These include protecting investors, improving audit quality, ensuring effective and efficient oversight of audit firms, helping to restore the public trust in the auditing profession and buttressing the efficient functioning of the capital markets.

- 8. Why does the PCAOB need eight regional offices? How big are they? Does it have plans to open more? What type of professionals are housed in the regional offices? How were the locations chosen? How long are the leases? What sort of growth plans are there for the various offices?**

In addition to its technology center in Virginia, the Board has seven regional offices throughout the country that house inspections staff. These staff are supervised locally by regional directors, but the inspections program as a whole is managed centrally in the Washington, D.C. headquarters. The Board chose the locations for each of these regional offices based primarily on the location of the registered public accounting firms which the Board is required to inspect. Each regional office has a lease term of approximately 10 years, with the exception of New York, which expires next year.

There are two primary reasons the Board determined to utilize regional offices in fulfilling its mission under the Act. First, as a result of having inspections personnel stationed throughout the country, travel costs associated with carrying out the Board's mandatory inspections program are reduced. Second, because many of the professional staff the Board seeks to hire reside in these cities or surrounding areas, the Board is able to attract and retain more highly skilled and experienced professionals who may otherwise not be inclined to relocate to Washington, D.C.

The following schedule shows the headcount as of January 31, 2005 and the projected headcount for December 31, 2005 for each of the regional offices, including the Virginia technology center:

	Atlanta	Chicago	Dallas	Denver	Los Angeles	New York	San Francisco	Virginia
<b>Jan-05</b>	19	7	21	8	12	36	10	43
<b>Dec-05</b>	27	19	25	17	19	50	16	60

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9. **Please describe how the PCAOB and the SEC's Office of the Chief Accountant work together.**

Under Section 107 of the Act, the SEC has general oversight authority of the Board's activities. The Board and its staff are therefore in frequent communication with the Office of the Chief Accountant, particularly on issues related to the establishment of auditing and related professional practice standards.

10. **Regulation PCAOB was a SEC regulatory project regarding how our two organizations would interact. Recent comments by PCAOB suggest that this project is no longer moving forward. Does the PCAOB intend to revive discussions about this project?**

Our understanding is that the SEC staff is no longer pursuing its proposal for rules known as "Regulation PCAOB." That said, we are in discussions with the SEC on how elements of the SEC's oversight that were addressed in Regulation PCAOB, such as the appeal of aspects of inspection reports, will be carried out.

11. **How much documentation does the PCAOB provide to the SEC on the PCAOB's budget? Will most, if not all, of this documentation be available to the public?**

After submitting the original 2005 budget to the SEC in October of 2004, the PCAOB began extensive discussions with the Commission's staff regarding the Board's budget. PCAOB staff from a number of offices, including those responsible for administration, finance, and personnel, gave presentations and provided supporting documentation for aspects of the PCAOB's budget. The SEC staff also met with the Board's IT specialists and reviewed their current and planned technology systems. This dialogue was robust and thorough, and continued for nearly four months. As part of its review, the SEC staff had access to PCAOB documents relevant to their review. The PCAOB also submitted numerous schedules and other supporting documentation to the staff of the Commission. In addition, while much of the information made available to the SEC staff is not appropriate for public availability (e.g., inspection schedules, details of IT security measures), the PCAOB has made a 28 page submission of supporting information related to its budget, which we understood would be made available to the public.

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- 12. What is the relationship between the PCAOB's enforcement group and the SEC's enforcement group? Is there a risk of duplication of effort? What is being done to ensure that duplication does not occur?**

Section 105(b)(4) of the Sarbanes-Oxley Act requires that the Board notify the Commission of any pending Board investigation involving a potential violation of the securities laws, and thereafter coordinate its work with the Commission's Division of Enforcement, as necessary to protect an ongoing Commission investigation. In practice, the enforcement staffs of our two organizations have developed a strong working relationship and are in frequent contact. While the PCAOB's and SEC's statutory responsibilities overlap in this area, through effective coordination in matters relating to registered firms and their associated persons, the staffs are making every effort to avoid unnecessary duplication of efforts.

- 13. In its December 30, 2004 press release, the PCAOB stated that its revised budget provides it with "significantly less flexibility to respond in the event of a further tightening of the job market for relevant professionals." Is the PCAOB suggesting that the SEC's actions in tightening its budget should be blamed for its hiring difficulties? Is the PCAOB suggesting that the SEC's oversight is hindering its ability to perform its function?**

The PCAOB's December 30, 2004 press release stated in part:

As provided for in the Act, the Board has and will continue to set staff salaries "at a level that is comparable to private sector self-regulatory, accounting, technical, supervisory, or other staff or management positions." While the Board has not yet considered salary adjustments for 2005, the revised budget anticipates that, in light of the tight job market for highly-skilled auditing professionals, the Board may need to reevaluate compensation in order to retain, and continue to attract, the talented and experienced professionals necessary for the Board to accomplish its mission. Like the original 2005 budget, the revised budget allows the Board to take this step if necessary, although with significantly less flexibility to respond in the event of a further tightening of the job market for relevant professionals. This risk is exacerbated by the fact that the Board approves a single budget as the basis for establishing the funds it will need to maintain operations for an entire calendar year.

This statement does not suggest that the SEC's review of the PCAOB's budget has caused it hiring difficulties or hindered its ability to perform its functions. The statement

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does reflect, however, that the Board's revision of its budget provides it "with significantly less flexibility to respond in the event of a further tightening of the job market for relevant professionals."

- 14. In this same press release, the PCAOB announced that \$1.3 million in consulting fees were cut. How much is the PCAOB spending on consulting fees? Who are these consultants? How were they selected? Will the PCAOB's reliance on consultants increase or decrease in the near term?**

The revised 2005 budget includes budgeted consulting fees of \$2.48 million. These consultants work in several areas, including the Board's inspections and standards-setting groups, as well as its Office of Financial Analysis and Risk Assessment. As reflected in the Board's inspection rules, the Board intends to use consultants, on a limited basis, to assist with aspects of its inspection program. These individuals are for the most part experienced, retired accounting firm partners, with expertise in technical issues that arise as part of the Board's inspections. Particularly, during this initial period when the Board is still trying to fill out the ranks of its inspections staff, these consultants have played an important role in helping the Board to meet its responsibilities. While we do not expect any reduced reliance on these experts in the near term, we do expect to gradually reduce our reliance on them over the longer term.

- 15. PCAOB ended 2004 with a large amount of unspent cash. Is PCAOB working to improve its cash management and forecasting ability?**

Due to its funding cycle, the PCAOB must begin each year with sufficient sums to fund its operations until the Board's budget is approved and it can assess and collect its accounting support fee for the coming year. In practice, this means that the Board needs to begin each year with three months of working capital to maintain continuous operations.

While the Board did not spend at the rate projected in its 2004 budget, the existence of a variance from budgeted to actual expenditures in the organization's second year of operations was not wholly unexpected. As the organization continues to ramp up to full operations and achieves a higher level of predictability, its ability to budget annual receipts and expenditures should improve. As reflected in the SEC's Order approving the Board's 2005 budget, the Board will conduct a self-assessment of its internal controls for its operations and budget during 2005.



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- 16. The PCAOB and the AICPA just entered into an agreement pursuant to which the PCAOB can publish the AICPA's auditing standards without paying a fee. Does the PCAOB plan to write its own standards? If so, does it plan to charge for them?**

Section 103(a)(1) of the Sarbanes-Oxley Act of 2002 directs the Board to establish auditing and related attestation standards, quality control standards, and ethics standards 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 Commission, or as may be necessary or appropriate in the public interest or for the protection of investors. Similarly, Section 103(b) authorizes the Board to establish such rules as may be necessary or appropriate to implement the auditor independence requirements in, or as authorized under, Title II of the Act.

Pursuant to this authority, in April 2003, the Board announced that it would adopt as interim standards the existing standards that had to that point been developed by the profession itself, as those standards existed on April 16, 2003. The Board and its staff have since been engaged in a process to identify which standards should be adopted as permanent, in whole or in part. In addition, the Board has adopted three new standards, including Auditing Standard No. 2, *An Audit of Internal Control Over Financial Reporting Conducted in Conjunction With an Audit of Financial Statements*, and continues to evaluate the need for additional standards. The PCAOB does not charge for access to these standards.

- 17. PCAOB has made significant expenditures for information technology ("IT") in order to build a strong IT platform from scratch. How large is the PCAOB IT staff? Will IT spending decrease in the near term?**

There are currently approximately 40 staff in the PCAOB's Information Technology department, and that number is budgeted to increase to 60 by the end of 2005. The 2005 Information Technology budget reflects the Board's shifting emphasis from IT infrastructure, necessitated by the startup nature of the Board in 2004, to IT applications. While difficult to forecast with any degree of certainty due to the Board's relatively early development stage, it is currently anticipated that the Information Technology component of the Board's 2006 and 2007 budgets will level off and eventually decrease as major infrastructure and technology application projects are expected to be completed during 2005. While some developing areas of the Board's operations, such as its risk assessment function, may require additional IT support and

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expenditures, other areas, including the Board's funding and registration systems, will enter or continue in a maintenance phase.