At its public meeting on December 19, 2006, the Public Company Accounting Oversight Board will consider whether to adopt certain amendments to the Board's inspection rules. The amendments to be considered include a temporary adjustment to inspection frequency requirements for firms with 100 or fewer issuer audit clients.

The Sarbanes-Oxley Act of 2002 ("the Act") requires the Board to conduct periodic inspections of each registered public accounting firm that "regularly provides" audits reports for issuers. For each registered public accounting firm that regularly provides audit reports for 100 or fewer issuers, the Act and PCAOB Rule 4003(b) require an inspection at least once every three years.¹

The three-year inspection cycle is firm-specific and depends upon when a firm first engages in certain conduct (such as issuing an audit report for an issuer) while registered with the Board. The end of 2006 will mark the end of the first three-year cycle for many firms, and the Board expects to end the 2004-2006 cycle having inspected 526 firms with 100 or fewer issuer audit clients. That number includes all of the firms that, under the criteria set out in the Act, were required to be inspected in the 2004-2006 cycle and more than 300 additional firms that will have had their first inspection even though their first three-year cycle does not end until 2007 or later.

The first three years of inspections coincided with the Board's initial growth and, as a consequence, the resources available for and devoted to the inspections of firms with 100 or fewer issuer audit clients increased each year. This resulted in a year-to-year fluctuation that, because of the minimum frequency requirements of Rule 4003(b), the Board would be locked into repeating in succeeding three-year periods.

¹ The Act and PCAOB Rule 4003(a) also require the Board to inspect annually each registered firm that regularly provides audit reports for more than 100 issuers. The amendment to Rule 4003 that the Board will consider does not affect the inspection frequency requirement for those firms.
To avoid that consequence, the Board will consider adding to Rule 4003 a new paragraph (d) that will temporarily adjust aspects of the inspection cycle requirement. Paragraph (d) would allow the Board 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. Paragraph (d) would accomplish that result by providing that, with respect to firms that became registered in 2003 or 2004, (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.2

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 would have its first inspection within the three-year period following its first issuance of such a 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.

The Board will consider adopting Rule 4003(d) as a final rule to take effect upon Commission approval. The Board will consider adopting Rule 4003(d) before obtaining public comment because the rule involves only a temporary adjustment, for administrative and programmatic reasons, to an existing rule to which the Board would not be making any permanent change. Nevertheless, the proposal that the Board will consider would include soliciting public comment on Rule 4003(d), and would include a provision that the rule would expire June 30, 2007 unless the Board, after considering any comment, decides to extend the rule.

* * *

The PCAOB is a private-sector, non-profit corporation, created by the Sarbanes-Oxley Act of 2002, to oversee the auditors of public companies in order to protect the interests of investors and further the public interest in the preparation of informative, fair, and independent audit reports.

2/ The Act authorizes the Board to adopt rules changing the minimum inspection frequency requirements set out in the Act.