At its public meeting today, the Public Company Accounting Oversight Board (the "Board" or "PCAOB") will consider whether to retain Rule 4003(d) relating to inspection frequency. The Board will also consider whether to propose, and seek public comment on, amendments to limit the Board's fixed periodic inspection requirement to firms that regularly issue audit reports.

Retaining Rule 4003(d) Relating to Inspection Frequency

The Sarbanes-Oxley Act of 2002 ("the Act") requires the Board to conduct at least one inspection every three years of any registered firm that regularly provides audits reports for 100 or fewer issuers, and PCAOB Rule 4003(b) implements that requirement. The Act also authorizes the Board to adopt rules changing that minimum frequency requirement, and the Board exercised that authority, in a narrow respect, to adopt Rule 4003(d) on December 19, 2006.1

Rule 4003(d) provides the Board with limited flexibility concerning the three-year requirement, for administrative and programmatic reasons, but with no applicability beyond a firm's second inspection. That flexibility allows the Board to minimize year-to-year fluctuations in the three-year inspection cycle that might otherwise remain embedded in the cycle as a result of the inspection program's gradual growth over its first three years. Specifically, Rule 4003(d) frees the Board to make scheduling adjustments that will result in a mix of inspected firms (in terms of the size and nature of

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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. Rule 4003(d) does not affect the inspection frequency for those firms.
audit practices) that is relatively consistent from year to year, while avoiding significant year-to-year fluctuations in inspection resource requirements.

In light of the nature of the rule, the Board adopted it as a final rule without first seeking public comment. The Board nevertheless invited public comment and provided that Rule 4003(d) would expire on June 30, 2007, unless the Board otherwise acted to retain it. The Board took that approach to ensure that the Board would need to act again, after receiving comment, before giving Rule 4003(d) any longer period of effectiveness. The Board received two comment letters, both expressing support for the rule. At its public meeting today, the Board will consider whether to eliminate the June 30 sunset provision and retain Rule 4003(d) and the scheduling flexibility that it provides the Board up through a firm's second inspection.²

As the Board noted when adopting Rule 4003(d), the Board ended the first three years of its inspection program (2004-2006) having inspected all of the firms that, under the criteria set out in the Act, were required to be inspected in that period as well as more than 300 additional firms that the Board was not required to inspect sooner than 2007.³ Moreover, even with Rule 4003(d) in place, the Board expects and intends 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 had its first inspection within the three-year period following the first year in which the firm issued such a report. The flexibility provided by Rule 4003(d) comes into play principally with respect to the timing of the second inspection of some of those firms, and the timing of the first two inspections of other firms.

Proposal to Limit Rule 4003's Fixed Periodic Inspection Requirement to Firms that Regularly Issue Audit Reports

The Act requires the Board to conduct regular periodic inspections of any registered firm that "regularly provides audit reports" for issuers. In 2003, the Board adopted an inspection frequency rule that implements that requirement but also, in two distinct respects, goes beyond that requirement. In Rule 4003(b), the Board provided that it would inspect, according to a fixed schedule, not only firms that regularly issue audit reports but also (1) any firm that issues any audit report for an issuer while registered, regardless of whether the firm regularly does so, and (2) any firm that plays a substantial role in the preparation or furnishing of an audit report, even if the firm never issues an audit report with respect to an issuer.

²/ The Board has previously submitted Rule 4003(d) to the Securities and Exchange Commission for approval, and that submission is pending.

³/ 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 Board's experiences in the first years of the inspection program have caused the Board to revisit this aspect of Rule 4003(b). Registered public accounting firms currently number 1,775. Of those firms, there are 694 that have issued audit reports with respect to issuers in both of the two most recent calendar years, and 135 others that have issued such audit reports in one of the two most recent calendar years. The Board is considering whether the focus of its regular inspection program should be squarely on such firms, without requiring regular diversion of resources to inspect firms that do not issue audit reports or firms that have not done so more recently than three years ago. Such an approach would be consistent with the risk-based focus that the Board generally brings to bear in considering the most prudent allocation of its inspection resources.

Accordingly, at its public meeting today, the Board will consider whether to propose, and seek public comment on, amendments to Rule 4003 to eliminate these two respects in which the Rule goes beyond the Act. The proposed amendments that the Board will consider would not diminish the Board's authority to inspect, at the Board's discretion, any registered firm at any time, but would more precisely align the rule and the Act regarding the universe of registered firms that the Board must inspect regularly.

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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.