

**SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-56517; File No. PCAOB-2006-03)**

**September 25, 2007**

**Public Company Accounting Oversight Board; Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto 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 and II below, which items have been prepared by the Board. On May 31, 2007, the Board amended its filing because certain of the information described in the original filing had changed. 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 in italics. 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**

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**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.

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

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(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

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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 inspected 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.

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 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

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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.

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. 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 invited public comment on Rule 4003(d), and the Board provided that Rule 4003(d) would expire on June 30, 2007 unless the Board, after considering any public comment, acted to adopt the rule for a longer period. The Board received two comment letters, each expressing general support for Rule 4003(d) and neither raising any issues concerning the rule. On May 24, 2007, the Board approved retaining Rule 4003(d) indefinitely beyond the tentative June 30, 2007 expiration date.

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 solicited comment on Rule 4003(d) when the Board adopted that rule on December 19, 2006. Since the filing of Form 19b-4 on December 20, 2006, the Board has received two comment letters on Rule 4003(d). Each comment letter expressed general support for Rule 4003(d), and neither comment letter raised any significant issues about the rule change. The Board did not solicit or receive comment on the other proposed rule changes described in Section I above.

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 Board 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 change is consistent with the requirements of Title I of the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/pcaob.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number PCAOB 2006-03 on the subject line.

Paper comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number PCAOB 2006-03. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/pcaob/shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change 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 Section, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and

3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of the PCAOB. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number PCAOB-2006-03 and should be submitted on or before **[insert date 21 days from publication in the Federal Register]**.

By the Commission.

Nancy M. Morris  
Secretary