SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-56738; File No. PCAOB-2006-03)  

November 2, 2007  

Public Company Accounting Oversight Board; Order Approving Proposed Rule Change and Amendment No. 1 Thereto Relating to Inspections  

I. Introduction  

On December 20, 2006, the Public Company Accounting Oversight Board (the "Board" or the "PCAOB") filed with the Securities and Exchange Commission (the "Commission") proposed rule amendments (PCAOB-2006-03) pursuant to Section 107(b) of the Sarbanes-Oxley Act of 2002 (the "Act"), relating to the Board’s rules governing inspections of registered public accounting firms. On May 31, 2007, the Board amended its filing because certain of the information described in the original filing had changed. Notice of the proposed rule amendments, including Amendment No. 1 to the proposed amendments, was published in the Federal Register on October 1, 2007.¹ The Commission received no comment letters relating to the proposed rule amendments. For the reasons discussed below, the Commission is granting approval of the proposed rule amendments.  

II. Description  

The PCAOB adopted its initial inspection rules at its public meeting on October 7, 2003, and authorized filing the rules with the Commission. After the appropriate comment period, the Commission approved the rules on June 1, 2004. On December 19, 2006, the PCAOB adopted amendments to its inspection rules to temporarily adjust the inspection frequency requirements for firms with 100 or fewer issuer audit clients and to 

¹ See SEC Release No. 34-56517 (Sep. 25, 2007); 72 FR 55839 (October 1, 2007).
provide for technical amendments to PCAOB Rule 4006, Duty to Cooperate with Inspectors, and PCAOB Rule 4009, Firm Response to Quality Control Defects. The PCAOB solicited public comments on the proposed amendments at that time. After reviewing the public comments received on the proposed amendments, the PCAOB adopted Amendment No. 1 to the proposed amendments and submitted an amended Form 19b-4 proposed rule change to the Commission. Pursuant to the requirements of Section 107(b) of the Act and Section 19(b) of the Securities Exchange Act of 1934 (the “Exchange Act”), the Commission published the proposed amendments for public comment on October 1, 2007.

III. Discussion

The Commission received no public comments relating to the PCAOB’s proposed amendments relating to its rules governing inspections of registered public accounting firms. Section 104 of the Act requires the PCAOB 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 PCAOB, the rules of the Commission, and professional standards, in connection with its performance of audits, issuance of audit reports, and related matters involving issuers. Section 104(b)(1)(B) of the Act requires the PCAOB 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 PCAOB to adopt rules adjusting that frequency.

In 2003, the PCAOB adopted Rule 4003(b), which provides that the PCAOB 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 plays 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 Board explained that 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. 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.

On December 19, 2006, the PCAOB adopted a proposed amendment to its Rule 4003 to temporarily adjust the minimum inspection frequency requirement applicable to certain firms. The Board explained that the proposed amendment 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.

The proposed amendment to PCAOB Rule 4003 provides that, with respect to firms that became registered in 2003 or 2004, (1) the PCAOB 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 in an audit, and (2) the PCAOB 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. Amendment No. 1 to the proposed amendments removes a sunset provision relating to Rule 4003 from the proposed amendments, which would have caused the proposed amendment to Rule 4003 to expire on June 30, 2007. The proposed amendments also include technical amendments to make corrections to PCAOB Rules 4006 and 4009.

The proposed amendments do not limit the PCAOB's authority to conduct inspections at any time, and do not affect registered firms' obligations under the Act. Even with this adjustment, the Board expects that each U.S. firm that issued an original 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. 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. As the Board explained, 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.

IV. Conclusion

On the basis of the foregoing, the Commission finds that the proposed amendments to the Board’s rules governing inspections of registered public accounting firms are consistent with the requirements of the Act and the securities laws and are necessary and appropriate in the public interest and for the protection of investors.

IT IS THEREFORE ORDERED, pursuant to Section 107 of the Act and Section 19(b)(2) of the Exchange Act, that the proposed rule amendments (File No. PCAOB-2006-03) be and hereby are approved.

By the Commission.

Florence E. Harmon
Deputy Secretary