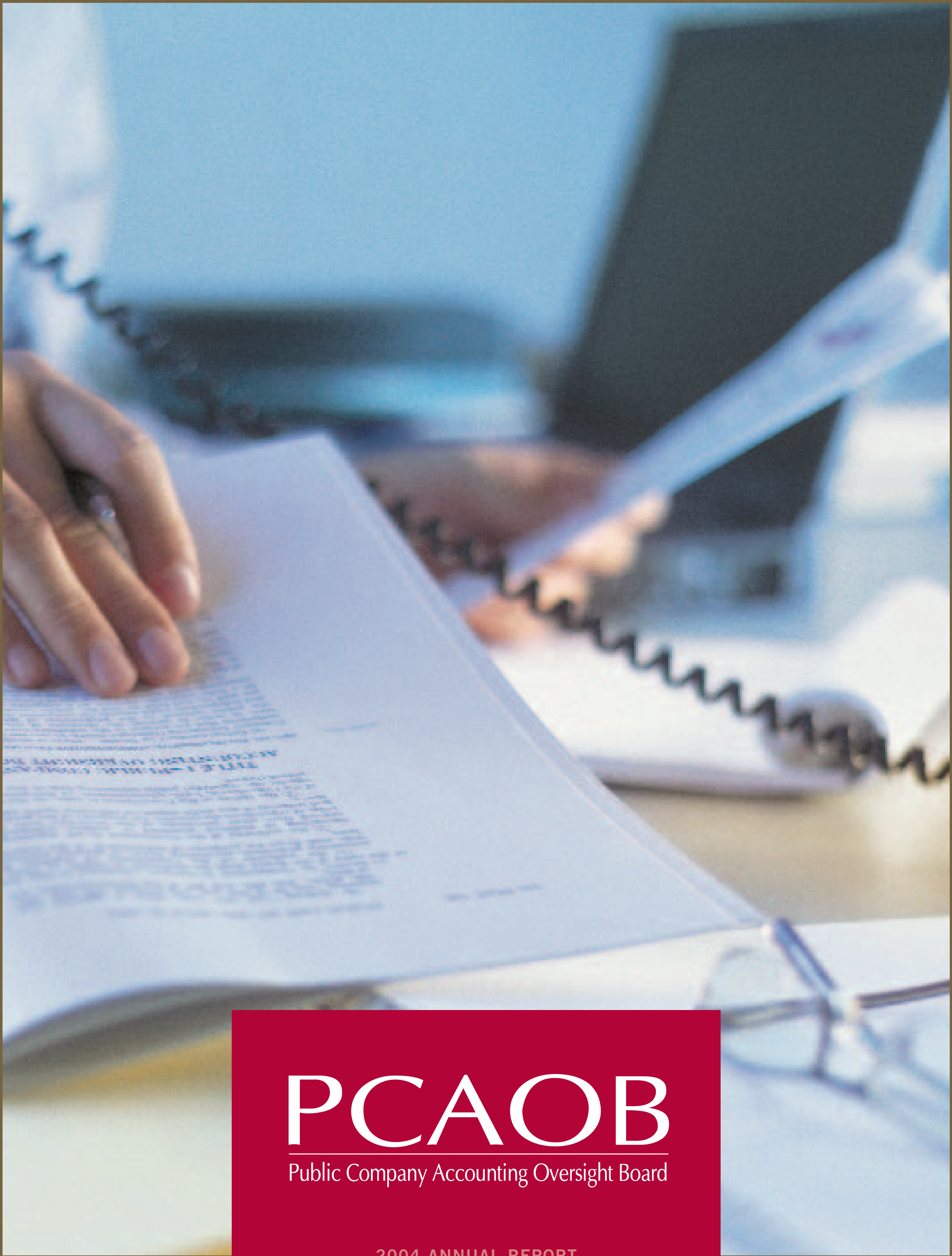


PCAOB

Public Company Accounting Oversight Board

2004 ANNUAL REPORT

The Public Company Accounting Oversight Board 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.

PCAOB

Public Company Accounting Oversight Board

FROM THE CHAIRMAN

On behalf of the Board and staff of the Public Company Accounting Oversight Board, I am pleased to present this report on our work in 2004.

The accomplishments detailed on the following pages could easily be read as the products of a mature organization, long accustomed to the business of crafting auditing standards, inspecting accounting firms, and otherwise overseeing the auditors who work in more than 1,400 public accounting firms across the globe.

In reality, these accomplishments were achieved in what was only the second year of operations of the PCAOB.

Fortunately, the Board and the public were well served in 2004 by the foundation that was set for the PCAOB in 2003. The construction of a Web-based system for the registration of public accounting firms, the performance of limited inspections of the four largest U.S. accounting firms, and the development of a process for establishing auditing standards gave the Board a firm base for the continuation and expansion of those activities in 2004.

The PCAOB continued in 2004 to fulfill its statutory duties under the Sarbanes-Oxley Act of 2002, most notably in launching the full-scale inspections of registered accounting firms and finalizing the standard under which auditors assess public companies' internal controls over financial reporting.

Beyond its statutory duties, the Board took important steps to ensure that the PCAOB is fully equipped to protect the interests of investors and further the public interest in the preparation of informative, fair, and independent audit reports.

For example, we increased the number of regional offices where our inspectors are based. We can now dispatch our staff of experienced auditors from eight cities, from the East Coast to the West Coast, to conduct the inspections of public accounting firms that are vital for assessing audit quality.

To help target our inspections, and to guide our standards-setting and rulemaking, we brought together an experienced team to perform financial and risk analysis. They will examine trends and data with an eye toward identifying potential trouble spots in financial reporting.

Throughout 2004, we were constantly mindful that the work of the PCAOB, by necessity, has a tremendous impact not just on accounting firms, but on public companies of all sizes and their shareholders. We invested a great deal of time and energy in seeking out the thoughts of auditors, directors, executives, academics, fellow regulators, and investors on our proposals and procedures. In formal and informal meetings, in the United States and in other countries, we sought out and received invaluable insight that we hope is reflected in our work.

We also responded quickly to requests for guidance and assistance. We published staff answers to frequent questions about audits of internal control, audits of non-public companies, and the registration and oversight of non-U.S. accounting firms. We launched a series of forums for the auditors and directors of small businesses.

We are mindful that our performance as an organization must be as pristine as the performance we expect from the firms we oversee. To that end, the Board hired a full-time ethics officer, whose job it is to help the Board and staff meet both the letter and the spirit of the robust ethics code that guides our activities inside and outside the PCAOB.

The Board also created an office to provide internal examination of the programs and operations of the PCAOB—much the way an inspector general would function in a government agency. With performance reviews and real-time quality assurance of PCAOB functions and programs, we expect that this office will help ensure the efficiency, effectiveness, and integrity of our activities.

The Sarbanes-Oxley Act endowed the PCAOB with a great deal of responsibility and authority. This report, which I convey to the Securities and Exchange Commission, to members of Congress, and to the public, sets out the work that we did in 2004 to fulfill the Act's intentions. It is my hope that the report also demonstrates that we take our responsibility seriously and exercise our authority with humility.

William J. McDonough
Chairman and Chief Executive Officer
Public Company Accounting Oversight Board
Washington, D.C.

April 2005

Overview

A STANDING-ROOM-ONLY CROWD OF MORE THAN 250 people filled the East Room of Washington's Mayflower Hotel on March 9, 2004, to witness the year's first open meeting of the Public Company Accounting Oversight Board.

On the Board's agenda that day was a highly anticipated new standard governing how auditors should assess companies' internal control over financial reporting, as well as a shift in the deadline for non-U.S. auditors to register with the Board; amendments to existing, interim standards to incorporate the new internal control standard; and changes to the Board's bylaws.

In many ways, the agenda of March 9 was a template for the Board's work throughout 2004, its second year of operation: momentous standards-setting; diplomatic accommodations with U.S. and foreign regulators; close attention to the effects of new auditing standards, including their costs, on auditors, issuers, and investors; and the expansion and adjustment of a still new, rapidly growing oversight organization.

The Board's actions on March 9 also underscored the commitment of the Board members and the PCAOB staff to fulfilling the Board's mission: 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.

The Board drew its mission from the Sarbanes-Oxley Act of 2002, the landmark legislation that created the PCAOB as the independent, nonprofit, non-governmental overseer of the auditors of public companies.

The Sarbanes-Oxley Act also set out the PCAOB's four key program areas for auditor oversight: registration, inspections, standards-setting, and enforcement. The four program areas were the heart of the PCAOB's work in 2004, but the Board took important steps to bolster and augment those programs during the year.

Among other initiatives, the Board

- expanded its outreach to issuers and auditors, paying particular attention to small accounting firms and public companies;
- furthered its dialogue with non-U.S. regulators;
- implemented vital risk-assessment functions to guide inspections, enforcement, and standards-setting; and
- established an internal oversight program to assess the effectiveness of the Board's operations.

Just as the meeting of March 9, 2004, was a template for the Board's work through the entire year, the accomplishments of 2004 are a template for the PCAOB's progress for years to come.

Outreach and Dialogue

In public meetings, roundtable discussions, speeches, and forums, the Board and the staff of the PCAOB do their utmost to ensure that all interested parties have the opportunity to hear, understand, and respond to the Board's proposals and positions.

At six public meetings in 2004, starting with the well-attended meeting of March 9, the Board proposed or adopted significant auditing standards and rules, including standards for audit documentation, audits of internal control over financial reporting, and the oversight of non-U.S. accounting firms.

The Board solicited, and published on its Web site, public comments on five rules or standards in 2004. Comments are considered carefully by the PCAOB staff and Board and are addressed when the Board adopts final rules or standards.

The Board and the PCAOB staff, through formal and informal meetings with interested parties, solicited additional comments on the Board's rules and standards. Those comments resulted in the Web-based publication of three sets of staff answers to common questions about the audits of internal control over financial reporting, as well as answers to common questions about audits of non-public companies that are performed pursuant to PCAOB standards.

To set the groundwork for standards-setting, the Board convened three two-day public meetings of its Standing Advisory Group and drew insight from the investors, issuers, and auditors who are members of the group.

On July 14, 2004, the Board hosted a public roundtable discussion on auditor independence as it relates to tax services, gathering valuable information that helped shape the Board's proposal in December of rules for ethics and independence in auditors' performance of tax services for audit clients.

In late November, the Board launched its initiative to reach the auditors in smaller accounting firms and the members of audit committees of small companies with the first in a series of forums to be held across the United States. The Forums on Auditing in the Small Business Environment are programs for registered accounting firms and directors of public companies in the small business community to learn more about the work of the Board, specifically the PCAOB inspections process and the impact of new auditing standards.

Throughout the year, the Board members and PCAOB staff hosted and traveled to meetings with investors, regulators, lawmakers, reporters, accounting associations, academics, students, corporate executives, and corporate board members to provide information about the Board activities that would affect their work and the public's confidence in public company financial statements.

To that end, the Board invested in the expansion of its international staff, both as advisors to the Board and in directing the Board's work in overseeing non-U.S. auditors that audit, or play a significant role in auditing, companies that trade in U.S. markets. The importance of the investment was underscored by the fact that almost one-third of the accounting firms registered with the Board by December 31, 2004, were based outside the United States in 76 countries.

The Board continued its important work with domestic regulators in 2004, particularly the Securities and Exchange Commission. The Sarbanes-Oxley Act gives the SEC oversight authority over the Board. In addition to its responsibility for appointing or removing members, the SEC, among other things, must approve the Board's budget and rules, including auditing standards, and may review appeals of disciplinary actions against registered accounting firms and appeals of certain matters relating to Board inspections of registered accounting firms.

Risk Assessment

The Board was created by Congress in response to a startling series of business failures—including accounting failures—that surfaced in late 2001 with the collapse of Enron and continued through the summer of 2002 with the bankruptcy filing by the former WorldCom.

The shock of those failures, and their effects on investors, motivated the Board to make risk assessment a vital part of its planning for inspections of registered accounting firms, as well as for standards-setting and enforcement.

The Board's Division of Registration and Inspections relies on risk assessment by an experienced team of auditors as it identifies, among other things, the audit engagements of the firms that will be inspected, with a goal of identifying the engagements that may pose the most significant and consequential auditing challenges.

To make these assessments, the Division examines public financial statements, reports of mergers and acquisitions, changes in auditors, announced restatements, and the results of PCAOB inspections, among other things. Such assessments enable the Division to focus its inspection efforts in ways that make the best use of its staff of inspectors and best protect investors.

In July 2004, the Board established its Office of Financial Analysis and Risk Assessment (OFARA) to collect, analyze, and assimilate information from multiple sources and provide the Board and its staff with assessments of risks that may influence public companies or their auditors to provide financial statements or other public information that are not truthful or are not fairly presented in all respects.

OFARA is staffed with accountants, analysts, and economists who will assess financial reporting risk through the identification of trends and anomalies in financial reporting. The staff will analyze information obtained from the PCAOB's inspections of registered accounting firms and use electronic databases, analysis, and other technology to enhance its efforts. OFARA will provide the Board with assessments of potential financial statement risks to assist the Board in its oversight of registered accounting firms.

Internal Oversight

In its first year of operation, the Board began to consider establishing an internal mechanism for assuring quality, accountability, and operational efficiency within PCAOB offices and activities. The Board's planning culminated in the creation of the office of Internal Oversight and Performance Assurance (IOPA) in early 2004.

IOPA's mission is to conduct internal reviews and examinations to help ensure the efficiency, effectiveness, and integrity of PCAOB programs and operations. As described in its charter, IOPA may conduct performance reviews of PCAOB activities, provide real-time quality assurance to the Board, and may also receive and review allegations of wrongdoing by PCAOB employees. The Board approved IOPA's charter on April 13, 2004.

To assist in the external oversight contemplated in the Sarbanes-Oxley Act, IOPA reports and records are made available, upon request, to the SEC. Summaries of IOPA performance reviews are also transmitted to the SEC and made available publicly on the Board's Web site.

In 2004, IOPA completed a review of the PCAOB's process for registering public accounting firms to assess the efficiency and effectiveness of the process. IOPA also designed, and the Board approved, a series of performance reviews to be conducted during 2004 and 2005 that focus on the progress of key PCAOB programs and functions in establishing effective and appropriate internal controls.

The first review in the series, completed in November 2004, focused on information technology and security. Both of these reviews identified many positive accomplishments. IOPA also made certain recommendations and observations to help the Board focus on the challenges that remain as it seeks to build a model regulatory oversight organization.

The Bottom Line

The PCAOB began operations in 2003 with four Board members and a handful of staff members in a single suite of offices; it began 2004 with five Board members and a staff of 116 in five cities. By the end of 2004, the PCAOB staff numbered 260 in eight cities.

In two years, the Board and the staff put together the infrastructure and rules necessary to conduct the registration, inspection, and discipline of accounting firms and issued important new standards to promote confidence in the financial statements of public companies.

In December 2004, a partner at an accounting firm penned a note on a holiday card to a PCAOB staff member: "You have changed all our lives."

Registration

THE SARBANES-OXLEY ACT OF 2002 PROHIBITS ACCOUNTING FIRMS that are not registered with the Board from preparing or issuing audit reports on U.S. public companies or from substantially participating in these activities.

The Board approved 688 registration applications in 2004, nearly doubling the number of registered public accounting firms. The Board also issued orders disapproving the registration of five public accounting firms during 2004.

The increase in registered public accounting firms in 2004 was due in large part to the registration of accounting firms based outside the United States. While non-U.S. accounting firms that audit U.S. issuers have long been subject to U.S. securities laws, as well as U.S. auditing standards, the Board recognized that registration of non-U.S. firms would raise additional issues. For this reason, the Board gave careful consideration to the impact of its registration rules on non-U.S. firms and adapted its registration rules to accommodate conflicts in law.

Number of Issuers Per Registered Firm

REGISTERED FIRMS (2003–2004)*	ISSUER CLIENTS
9	101 or more
8	51–100
27	26–50
81	11–25
113	6–10
600	1–5
585	0

* This number does not include firms that have subsequently withdrawn from registration.

When the Board adopted its registration rules on April 23, 2003, it gave non-U.S. firms an additional six months to register beyond the deadline for U.S. firms. The deadline for non-U.S. firms to register was later extended an additional three months to July 19, 2004.

Among other accommodations crafted for non-U.S. firms was permission for foreign applicants to withhold information from a registration application when submission of such information would cause the applicants to violate a non-U.S. law. In exchange, the Board's rules require non-U.S. applicants relying on this provision to submit a copy of the relevant portion of the conflicting non-U.S. law, a legal opinion that submitting the information would cause the applicants to violate the conflicting non-U.S. law, and an explanation of the applicants' efforts to seek consents or waivers to eliminate the conflict.

The Board's rules require all public accounting firms to submit their applications for registration through the Board's Web-based registration system. The Board must determine, using the information provided during the registration process by each applicant accounting firm, and any other information obtained by the Board, whether the registration of such accounting firm would be consistent

Registration continued

with the Board's responsibilities to protect investors and to further the public interest in the preparation of informative, fair, and independent audit reports.

The Act and the Board's rules give the Board 45 days to review each application, after which the Board approves the application, provides the applicant with a notice of hearing to determine whether the application should be approved or disapproved, or requests more information from the applicant. The receipt of the requested information triggers another 45-day review period.

If the Board is unable to determine that a public accounting firm's application has met the standard for approval, the Board may provide the firm with a notice of hearing, which the firm may elect to treat as a written notice of disapproval that can be appealed directly to the Securities and Exchange Commission. Alternatively, the firm may request a hearing by the Board.

In its orders disapproving the registration of public accounting firms during 2004, the Board found that four firms had issued audit reports for public companies without having registered in accordance with Board rules. Each of these four firms consented to the order without admitting or denying the Board's findings. The Board found that a fifth firm had demonstrated both an unwillingness to comply with requirements imposed by a professional body and a lack of candor with the Board. The Board's findings regarding each firm are available on the Board's Web site.

The Board's rules also set out procedures for firms to withdraw from registration. Withdrawal is not automatic. The Board may order that withdrawal be delayed, for up to 18 months, while the Board carries out a relevant inspection, investigation, or disciplinary proceeding. In 2004, 21 firms withdrew from registration.

At the end of 2003, 735 U.S.-based accounting firms were registered with the PCAOB. By the end of 2004, the number of registered firms had grown to 1,423, including 530 non-U.S. firms based in 76 countries.

International Oversight

The Sarbanes-Oxley Act directly affects as many as 15,000 U.S. public companies. Those companies are headquartered in the United States, but they often have significant operations in other countries as well. Separately, the securities of about 1,200 public companies based outside of the United States trade in U.S. securities markets, and those companies must follow many of the requirements of the Act.

As a result, the Sarbanes-Oxley Act and the Board's rules require oversight of all public accounting firms that prepare or issue, or play a substantial role in the preparation or issuance of, any audit report on financial statements that are filed in the United States, regardless of where the firms are located.

During 2004, 530 accounting firms based outside of the United States registered with the PCAOB, bringing the total number of registered accounting firms to 1,423. The non-U.S. firms are based in 76 countries.

Beginning in the earliest months of its operation, the Board commenced a constructive dialogue with non-U.S. regulators concerning the oversight of accounting firms that audit public companies and the possible development of cooperative arrangements for such oversight.

This continuing dialogue has demonstrated that the Board and its non-U.S. counterparts share many of the same objectives. These include protecting investors from inaccurate financial reporting, improving audit quality, ensuring effective and efficient oversight of accounting firms, and helping to restore the public trust in the auditing profession.

Underlying this convergence of views is the global nature of the capital markets. In these markets, the effects of a corporate reporting failure in one country tend to ripple through the financial markets of another, potentially causing substantial economic damage. The Board believes that the best way to fulfill its mission—that is, protection of investors in the U.S. markets—is to participate in global efforts to protect investors in all markets.

To that end, the Board believes that it is in the interests of the investing public and the Board's non-U.S. counterparts to develop effective cooperative arrangements among regulators.

The Board formally adopted this approach on June 9, 2004, in its rules for oversight of non-U.S. public accounting firms. The rules were approved by the U.S. Securities and Exchange Commission on August 30, 2004.

The Board hopes that its approach to oversight of non-U.S. public accounting firms will encourage improvements in audit quality for firms in jurisdictions that have or create independent and rigorous auditor oversight systems. Already, significant changes in the regulation of non-U.S. accounting firms are underway in certain jurisdictions, including a number of proposals for the creation of new bodies to improve audit quality and verify compliance with local auditing and related professional practice standards.

For example, the European Commission proposed its 8th Company Law Directive in March 2004, calling for external and independent oversight of auditors in a system that is required to be transparent, well-funded, and “free from any possible undue influence by statutory auditors or audit firms.” The directive was approved by E.C. finance ministers in December 2004.

Shortly after the directive was proposed, the PCAOB was represented by its Chairman at a meeting of the heads of audit oversight bodies from the member countries of the European Union for a discussion of common interests in oversight. In addition, the Board and its staff have initiated discussions or established contact with many non-U.S. authorities, including those from Australia, Canada, Chile, France, Germany, Ireland, Israel, Japan, Korea, the Netherlands, Norway, Poland, Switzerland, Taiwan, and the United Kingdom.

The Board’s approach to the oversight of non-U.S. firms endeavors to build upon the work of new and existing oversight bodies in order to minimize administrative burdens and legal conflicts that firms face and to conserve Board resources, without undermining the Board’s statutory mandates.

Specifically, the oversight rules adopted by the Board set forth a model for inspections of non-U.S. firms under which the Board may rely on the work of the home-country regulator. Non-U.S. registered firms are subject to PCAOB inspections in the same manner as U.S. firms: annual inspections for firms with more than 100 public company audit clients and inspections once every three years for firms with more than one public company audit client.

Currently, one Canadian public accounting firm has more than 100 U.S. issuer clients and is subject to annual inspections. The remaining non-U.S. accounting firms registered with the PCAOB, distributed across 76 countries, are subject to inspections on at least a triennial basis starting in 2005.

The degree of reliance on home-country inspections will be based on the independence and rigor of the home-country system of oversight and agreement between the PCAOB and the home-country regulator on the inspection work program for individual firms. The more independent and rigorous the home-country system, the more the Board may rely on it to conduct an inspection of a PCAOB-registered firm.

The Board has also demonstrated its willingness to assist non-U.S. authorities in their oversight of U.S. firms that are registered with the PCAOB and are also within the regulatory jurisdiction of non-U.S. authorities. The oversight rules provide for the Board to assist non-U.S. regulators on inspections and investigations of U.S. firms subject to dual oversight.

In addition to working with its counterparts in oversight of accounting firms, the Board supports efforts of non-U.S. regulators and professional bodies to develop high-quality professional standards for auditing. The Board believes these efforts lead to the use of improved standards throughout the world, resulting in higher audit quality and more reliable financial reporting. This will benefit financial statement users everywhere, including those in the United States. To that end, the PCAOB participates as an observer, with speaking rights, at meetings of the International Auditing and Assurance Standards Board (IAASB) and meets periodically with other national standards-setters. Similarly, the IAASB participates as an observer at meetings of the Board’s Standing Advisory Group.

With an eye toward international convergence of auditing standards and with the belief that the PCAOB can learn from the work of other standards-setters, the Board’s staff considers relevant International Standards on Auditing (ISAs) issued by the IAASB in developing proposals to the Board. Conversely, other standards-setters are using the work of the PCAOB. For example, the IAASB recently issued for public consideration a proposed revised ISA on audit documentation that is consistent with the principles of the Board’s Auditing Standard No. 3 and a proposed Policy Statement similar to the Board’s rule for certain terms used in auditing and related professional practice standards.

Number of Registered Firms by Country
(Registered by 12/31/2004)

COUNTRY	NUMBER OF REGISTERED FIRMS
Canada	51
United Kingdom	37
Australia	28
Hong Kong	24
France	22
India	20
Germany	19
China	15
Brazil, Israel	13
Singapore	12
Spain	11
Belgium, Republic of Korea	10
Netherlands, New Zealand, Taiwan	9
Ireland, Italy, Mexico	8
Argentina, Indonesia, Japan, Russian Federation, South Africa, Turkey	7
Malaysia, Philippines, Poland, Portugal, Switzerland, Venezuela	6
Colombia, Costa Rica, Czech Republic, Finland, Norway, Sweden, Thailand	5
Austria, Bermuda, Cayman Islands, Chile, Denmark, Greece, Hungary, Kazakhstan, Panama, Peru, Romania	4
Luxembourg	3
Bahrain, Bolivia, Egypt, Iceland, Pakistan, Slovakia, Slovenia, Ukraine	2
Bahamas, Belize, Brunei Darussalam, Cambodia, Cyprus, Dominican Republic, El Salvador, Georgia, Ghana, Haiti, Lao People’s Democratic Republic, Lebanon, Mauritius, Papua New Guinea, Paraguay, United Arab Emirates, Uruguay, Vietnam	1

Inspections

THE SARBANES-OXLEY ACT REQUIRES THE BOARD TO CONDUCT A CONTINUING program of inspections of registered accounting firms to assess compliance with the Act, the rules of the Board, the rules of the Securities and Exchange Commission, and professional standards in connection with the firm's performance of audits, issuance of audit reports, and related matters involving issuers.

The Act requires the Board to conduct annual inspections of the registered firms that audit more than 100 public companies. Other firms that audit, or play a substantial role in auditing, any public companies are required to be inspected at least once every three years. The Board also has the authority to conduct special inspections as is necessary or appropriate to address issues that come to the Board's attention.

In 2004, the PCAOB's Division of Registration and Inspections inspected 99 registered accounting firms: the eight U.S. accounting firms with more than 100 public company audit clients and 91 firms with 100 or fewer public company audit clients. In January 2005, the Board began releasing reports of those inspections.

The Board's inspection teams are composed of accountants who have an average of 12 years of auditing experience. To facilitate the inspections of the national and regional offices of the largest firms and the inspections of the widely dispersed smaller firms, the Board's inspection teams are located across the United States in PCAOB offices in Atlanta, Chicago, Dallas, Denver, New York City, Orange County, San Francisco, and Washington, D.C.

The Act provides that an inspection must include at least the following three general components:

- an inspection and review of selected audit and review engagements of the firm, performed at various offices and by various associated persons of the firm;
- an evaluation of the sufficiency of the quality control system of the firm and the manner of the documentation and communication of that system by the firm; and
- performance of such other testing of the audit, supervisory, and quality control procedures of the firm as are necessary or appropriate in light of the purpose of the inspection and the responsibilities of the Board.

To help focus its inspections, the Board's Division of Registration and Inspections relies on risk assessment by an experienced team of auditors as it identifies, among other things, the audit engagements of the firms that will be inspected, with a goal of identifying the engagements

"We focus our inspections on the business context in which audits are performed. Without ignoring issues related to compliance with standards, we look at the tone at the top of the firms, whether the messages from the top carry throughout the organization, how partner compensation is structured, and whether or not the compensation structure rewards good auditing."

—Charles D. Niemeier,
Board Member, to the American Institute of Certified Public Accountants,
December 7, 2004

that may pose the most significant and consequential auditing challenges.

The Act requires the Board to prepare a report concerning each inspection and provides that the report "shall be (1) transmitted, in appropriate detail, to the SEC and each appropriate State regulatory authority … and (2) made available in appropriate detail to the public [subject to certain restrictions]."

In August 2004, the Board issued its first four inspection reports, based on its limited inspections in 2003 of the four largest U.S. accounting firms—Deloitte & Touche LLP, Ernst & Young LLP, KPMG LLP, and PricewaterhouseCoopers LLP. The limited inspections conducted in 2003 provided an important foundation for the full-scale inspections that began in 2004 and included each of the components required by the Act.

In accordance with the Act's requirement, the Board made public certain portions of those reports, by posting the reports to the Board's Web site. The Board also transmitted the full reports to the SEC and to certain state regulatory authorities. In addition, the Board transmitted to each firm a copy of the report of that firm's inspection.

With the reports on the 2003 limited inspections, the Board issued a Statement Concerning the Issuance of Inspection Reports that sets out the Board's policy for, and statutory restrictions on, the information it will provide in the reports on the 2004 inspections and inspections in the future.

Criticisms of, or Potential Defects in, the Firm's Quality Control Systems

Board inspection reports address quality control issues and may discuss criticisms of, and potential defects in, the firm's quality control systems. The Act, however, limits the public availability of those discussions. Specifically, the Act provides that no portions of the inspection report that deal with criticisms of or potential defects in the quality control systems of the firm under inspection shall be made public if those criticisms or defects are addressed by the firm, to the satisfaction of the Board, not later than 12 months after the date of the inspection report.

If quality control criticisms or defects are not addressed to the Board's satisfaction within 12 months, the Board will make those portions of the report public (subject to the firm's right, under the Act, to seek SEC review of the matter). If a firm disagrees with the Board's determination that criticisms or defects identified in an inspection report have not been addressed to the Board's satisfaction, the firm may, within 30 days of that determination, seek review by the SEC. The SEC's decision on the matter is final and not reviewable.

Public Portions of Inspection Reports

The public portions of the inspection reports may include two general categories of information. First, the reports may include descriptions of the types of matters on which the Board focused its inspection procedures. Because the reports issued on August 26, 2004, were the Board's first reports, they contain somewhat more detail about procedures than future reports will typically include.

Second, the public portions of the reports may include descriptions of issues identified by the Board's staff in the course of reviewing the firms' performance on selected audit engagements. Specifically, the reports may describe apparent departures from auditing standards, related attestation standards, ethical standards, independence standards, and the firm's own quality control policies and procedures. Those departures described in the report may include failures by the firm to identify or appropriately address apparent errors in an audit client's application of Generally Accepted Accounting Principles (GAAP).

The Board recognizes that the ultimate authority for determining an issuer's compliance with GAAP rests with the SEC. Nevertheless, through discussions with a firm or through reporting to the SEC, the Board's inspection work may sometimes start a process that results in an issuer restating its financial statements. Indeed, the Board is aware that some issuers have publicly described restatements as related to issues raised by the Board while reviewing the issuers' audits as part of the inspection process.

While Board inspection reports may indicate that issues raised by the Board led one or more issuers to restate financial statements, the inspection reports will not identify the issuers or describe the restatements in detail. Whether an issuer discloses the circumstances leading to its restatement is a matter within the jurisdiction of the SEC, not the Board.

Nonpublic Information Concerning a Firm or Its Clients

In providing for the Board to make some portion of the report public, the Act also expressly restricts the Board from making public any information that is subject to the protection of the Sarbanes-Oxley Act, which provides for the confidentiality of "all documents and information prepared or received by or specifically for the Board, and deliberations of the Board and its employees and agents, in connection with an inspection…or with an investigation.…"

In the context of an inspection report, the Board generally will maintain as nonpublic any otherwise nonpublic information that the Board obtained concerning the firm or its clients (except where disclosure of the nonpublic information is incident to disclosure of a quality control defect that the firm has not addressed to the Board's satisfaction). This restriction, however, does not prevent the Board from publicly describing its observations about apparent failures or deficiencies in a firm's actual performance of audits. While the public portion of inspection reports will generally include discussion of observations arising out of the review of specific audit engagements, the reports will not identify the issuers in question.

Certain Matters Not Included in Any Portion of an Inspection Report

When, in the course of reviewing a firm's performance on selected audits, the Board identifies possible departures from GAAP in an issuer's financial statements, the Board will encourage the firm to consider the issue and to review it with the audit client.

If it appears to the Board that the departure is material to the issuer's financial statements, the Board generally will not identify the issuer in an inspection report but will report the information to the SEC. The SEC has authority to prescribe the form and content of an issuer's financial statements, has direct authority with respect to issuers, and has long-established processes for addressing issuers' accounting practices.

In the course of an inspection, the Board may identify acts, practices, or omissions to act that may constitute a violation of law, Board rules, SEC rules, or professional standards. The Act provides that when the Board identifies such potential violations, the Board should, where appropriate, begin a formal investigation or disciplinary proceeding (including a hearing on the record) or report the matter to the SEC or the appropriate state regulatory authority.

The Act requires that the Board's investigations and disciplinary proceedings, including allegations of violations, remain nonpublic (absent the consent of all parties to make the proceeding public) unless and until the Board finds a violation after a hearing on the record and the respondent has had an opportunity to seek SEC review of that finding.

Auditing Standards

THE FIRST AUDITING STANDARDS DEVELOPED BY THE PUBLIC Company Accounting Oversight Board were adopted by the Board and approved by the Securities and Exchange Commission in 2004. Two of the standards, dealing with audit documentation and audits of internal control over financial reporting, were mandated by the Sarbanes-Oxley Act of 2002. One standard—requiring references in audit reports to PCAOB standards in lieu of references to Generally Accepted Auditing Standards (GAAS)—both recognizes and communicates that the related engagements have been performed pursuant to the standards of the PCAOB.

> Auditing Standard No. 2 "brings into sharp focus the many issues that are central to the question of how best to protect investors by improving the accuracy and reliability of corporate disclosures—precisely the principal purpose of the legislation that created the Public Company Accounting Oversight Board."
>
> —**Bill Gradison,** Board Member, at an open Board meeting, March 9, 2004

The Board establishes new auditing standards and changes existing standards only by Board rulemaking. Although the Board will consider proposed new or amended auditing standards recommended to it, no such proposed rule will become a standard of the Board unless adopted by the Board through rulemaking.

The Board relies on advice from its Standing Advisory Group to assist it in performing its standards-setting responsibilities. The Board named the members of the group—which include investors, auditors, issuers, and others interested in the quality of financial reporting and auditing—in April 2004 and convened three meetings beginning in June 2004.

The Board also solicits public comment and, where appropriate, convenes hearings or roundtable meetings to obtain the views of issuers, accountants, investors, and other interested persons with respect to proposed auditing standards. The Board welcomes input and advice from established professional accounting bodies and includes practicing accountants among the members of its advisory groups.

As a result of the Board's solicitation of views on the proposal and implementation of PCAOB auditing standards and rules, the Board's staff responded with guidance in the form of answers to frequently asked questions regarding audits of internal control over financial reporting and audits of non-public company clients pursuant to PCAOB standards.

Similarly, a roundtable discussion with investors, issuers, and accountants in July 2004 helped the Board formulate its proposal for ethics and independence rules regarding contingent fees and auditors' provision of tax services to audit clients.

PCAOB Auditing Standards

The Board's standards-setting authority is grounded in the Sarbanes-Oxley Act, which authorizes the Board to establish "such auditing and related attestation standards, such quality control standards, and such ethics standards to be used by registered public accounting firms in the preparation and issuance of audit reports, as required by this Act or the rules of the Commission, or as may be necessary or appropriate in the public interest or for the protection of investors."

On April 16, 2003, the Board adopted certain existing standards as its interim auditing and related professional practice standards. Most of these standards were promulgated by the American Institute of Certified Public Accountants (AICPA) and pre-date the Board's formation. These interim standards are incorporated into the Board's rules. Registered public accounting firms are subject to the same obligation to comply with the interim standards while they are in effect as with permanent standards adopted by the Board.

In September 2004, the Board announced that it would publish its interim standards on the Board's Web site, an action made possible by the consent of the AICPA. The ability to publish the AICPA-developed standards allows the Board appropriately and clearly to convey to auditors their current responsibilities in auditing public companies. The publication of the interim standards on the Board's Web site also enables the Board to more effectively communicate the effects that new, permanent standards developed by the Board have on the interim standards.

Auditing Standard No. 1: PCAOB Standards

The Board's first permanent auditing standard appropriately set out the language to be used by registered public accounting firms in their reports on the financial statements of public companies. The standard requires that the reports include a statement that the engagement was conducted in accordance with "the standards of the Public Company Accounting Oversight Board (United States)." The standard supersedes previously required references to "generally accepted auditing standards," "U.S. generally accepted auditing standards," "auditing standards generally accepted in the United States of America," and "standards established by the AICPA." The standard was approved by the SEC on May 14, 2004, and became effective for audit reports issued or reissued on or after May 24, 2004.

Auditing Standard No. 2: Audits of Internal Control

Section 404 of the Sarbanes-Oxley Act and the related implementing rules of the SEC require certain companies to include in their annual reports filed with the Commission a report on management's assessment of the effectiveness of the companies' internal control over financial reporting. In addition, Section 404 requires the companies' auditors to attest to and report on the internal control assessments made by management.

PCAOB Auditing Standard No. 2, which refers to the auditor's attestation as an audit of internal control over financial reporting, is the standard the auditor must use to report on a company's internal control over financial reporting under Section 404. The Board approved its standard on March 9, 2004, and the standard was approved by the SEC on June 17, 2004.

The Board emphasized in Auditing Standard No. 2 that an auditor should be aware that the people who rely on the information concerning internal control over financial reporting include investors, creditors, directors, audit committees, and regulators in specialized industries, such as banking or insurance. The auditor should be aware that external users of financial statements are interested in information on internal control over financial reporting because it enhances the quality of financial reporting and increases their confidence in financial information, including financial information issued between annual reports, such as quarterly information. Information on internal control over financial reporting is also intended to provide an early warning to those inside and outside the company who are in a position to insist on improvements in

"The reliability and integrity of the audit process are inseparable from the existence of a complete and understandable written record of the work that the auditor performed, of the conclusions that the auditor reached, and of the evidence that supports those conclusions. And, as a corollary, in order for the Board's inspectors to do their job, clear and comprehensive documentation standards are essential. Without such standards, we would not be able to assess whether firms are following the professional standards when they audit public companies."

—**Daniel L. Goelzer,** Board Member, at an open Board meeting, June 9, 2004

internal control over financial reporting, such as the audit committee and regulators in specialized industries.

The auditor's objective in an audit of internal control over financial reporting is to express an opinion on management's assessment of the effectiveness of the company's internal control over financial reporting. Maintaining effective internal control over financial reporting means that no material weaknesses exist; therefore, the objective of the audit of internal control over financial reporting is to obtain reasonable assurance that no material weaknesses exist as of the date specified in management's assessment.

To obtain reasonable assurance, the auditor evaluates the assessment performed by management and obtains and evaluates evidence about whether the internal control over financial reporting was designed and operated effectively.

Because the Board's standard for audits of internal control was linked so closely to the SEC's rules for management's assessment of internal control, the Board and the PCAOB staff worked closely with the SEC staff on the implementation of the standard. For example, the staff of the SEC and the PCAOB coordinated the issuance of guidance for issuers and for auditors on June 23 and again on October 6, 2004. The PCAOB guidance, in the form of staff answers to frequently asked questions, was supplemented on November 22, 2004.

When the Board adopted PCAOB Auditing Standard No. 2, it recognized that the internal control standard amended or superseded the professional standards adopted by the Board as its interim standards in some respects.

Accordingly, the Board on September 15, 2004, adopted conforming amendments to identify specific changes to the interim standards that result from the adoption of PCAOB Auditing Standard No. 2. The Board believes that identification of such changes is helpful in enabling auditors to comply with the Board's standards, as well as in eliminating potential confusion and inconsistencies in interpretation with respect to the portions of the interim standards affected by the adoption of PCAOB Auditing Standard No. 2. The conforming amendments were approved by the SEC on November 17, 2004.

The SEC and the PCAOB staff again worked closely when the Commission, on November 30, 2004, issued an order delaying the filing deadline for the first of these internal control reports for certain companies. Under the Commission's order, accelerated filers with a market capitalization of less than $700 million and a fiscal year ending between and including November 15, 2004, and February 28, 2005, were provided an additional 45 days to file management's first report on internal control over financial reporting and the related reports of their auditors, as long as those companies meet certain conditions.

To facilitate the objectives of the Commission's order, the Board adopted a temporary transitional rule applicable to audits of companies that rely on the Commission's order. The temporary rule permits those companies' auditors to date their reports on management's assessment of the effectiveness of internal control over financial reporting later than the date of their reports on the financial statements and to omit a required reference in the financial statement audit report to a separate report on internal control over financial reporting.

Auditing Standard No. 3: Audit Documentation

The Sarbanes-Oxley Act expressly directed the Board to establish auditing standards that require registered public accounting firms to prepare and maintain, for at least seven years, audit documentation "in sufficient detail to support the conclusions reached" in the auditor's report.

Accordingly, the Board made audit documentation a priority in its standards-setting responsibilities. The Board commenced a standards-development project on audit documentation with a public roundtable on September 29, 2003, to discuss issues related to documentation. Drawing on that discussion, the Board proposed its standard for audit documentation on November 21, 2003.

The Board approved Auditing Standard No. 3 on June 9, 2004, after considering comments on the proposed standard from a variety of interested parties, including auditors, regulators, professional associations, and government agencies. The SEC approved the standard on August 25, 2004.

The Board's standard on audit documentation will be one of the fundamental building blocks on which both the integrity of audits and the Board's oversight will rest.

The integrity of an audit depends, in large part, on the existence of a complete and understandable record of the work that the auditor performed, the evidence gathered, and the conclusions reached. Clear and comprehensive audit documentation is essential for auditors to enhance the quality of the audit and for the Board to fulfill its mandate to inspect registered public accounting firms "to assess the degree of compliance" of those firms with applicable standards and laws.

Ethics and Independence Rules

The Sarbanes-Oxley Act directs the Board to establish "ethics standards to be used by registered public accounting firms in the preparation and issuance of audit reports." The Act also directs the Board to establish rules on auditor independence "as may be necessary or appropriate in the public interest or for the protection of investors...."

Beginning in late 2003, the Board and the PCAOB staff took steps to evaluate whether an auditor's provision of tax services, or any class of tax services, to an audit client impairs the auditor's independence from that audit client, in fact or appearance.

As part of its evaluation of tax services and auditor independence, the Board held a public roundtable discussion on July 14, 2004, with 26 participants, representing investors, issuers, accounting firms, the Internal Revenue Service, the SEC, and the Government Accountability Office.

The Board took into account recent actions by the Internal Revenue Service and the U.S. Department of Justice against accounting firms in connection with those firms' marketing of tax shelter products and, specifically, those firms' alleged failures to register, or comply with list maintenance requirements relating to, their tax shelter products. The Board also considered testimony elicited during U.S. Senate hearings in November 2003 describing certain potentially abusive tax shelter products marketed through cold-call selling techniques by accounting firms and others.

The Board also considered that some audit firms have been publicly criticized for providing tax services, including tax shelter products, to senior executives of public company audit clients. Some critics have questioned whether an auditor's provision of such services could lead to conflicts of interest.

"I believe that many of the auditing problems the Board identifies will be dealt with through a combination of inspection reports and standards-setting. However, inevitably, situations will arise in which those tools are inadequate. There will be cases in which there are serious violations of Board standards or the securities laws by auditors under our jurisdiction. In those cases, the Board has the power to conduct investigations and to impose disciplinary sanctions, which can include fines, suspensions, and bars from auditing public companies."

—**Kayla J. Gillan,** Board Member, to the National Association of Corporate Directors, October 18, 2004

On December 14, 2004, the Board voted to propose rules to promote the ethics and independence of registered public accounting firms that audit and review financial statements of U.S. public companies. The proposed rules would treat a registered public accounting firm as not independent of an audit client if the firm, or an affiliate of the firm, provided any service or product to an audit client for a contingent fee or a commission, or received from an audit client, directly or indirectly, a contingent fee or commission.

The proposed rules also would treat such a firm as not independent if the firm, or an affiliate of the firm, provided assistance in planning, or provided tax advice on, certain types of potentially abusive tax transactions to an audit client or provided any tax services to certain senior officers of an audit client.

Further, the proposed rules would require registered public accounting firms to provide certain information to the audit committee of an audit client in connection with seeking pre-approval to provide non-prohibited tax services to the audit client.

In addition to these rules relating to tax services, the Board also proposed a general rule requiring registered public accounting firms to be independent of their audit clients throughout the audit and professional engagement period.

Finally, the Board proposed a rule on the responsibility of associated persons not to cause registered public accounting firms to violate the Sarbanes-Oxley Act, the rules of the Board, the provisions of the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, including the rules of the SEC issued under the Act, and professional standards.

Standing Advisory Group

Throughout 2004, the Board and the PCAOB staff met formally and informally with a variety of individuals and groups, both domestic and international, whose experience and interest would help the Board formulate its auditing standards. Such meetings included, and will continue to include, investors, professional accounting groups, U.S. and non-U.S. regulators, auditors, academics, corporate directors, and executives.

The Board also implemented a section of the Sarbanes-Oxley Act that requires the Board to "convene, or authorize its staff to convene, such expert advisory groups as may be appropriate" to make recommendations regarding auditing and related professional practice standards.

On April 15, 2004, the Board announced the formation of its Standing Advisory Group with the selection of 30 individuals with expertise in a variety of fields, including accounting, auditing, corporate finance, corporate governance, and investing in public companies.

The members of the advisory group serve in their individual capacities and may not delegate their duties as advisory group members, including attendance at meetings. Advisory group members are also subject to certain provisions of the Board's Ethics Code, including provisions designed to protect nonpublic information and avoid conflicts of interest.

The Board also granted six organizations observer status with speaking rights at all meetings of the Standing Advisory Group. Those six organizations are the SEC, the Financial Accounting Standards Board, the Government Accountability Office, the International Auditing and Assurance Standards Board, the U.S. Department of Labor, and the Auditing Standards Board of the American Institute of Certified Public Accountants.

The Standing Advisory Group convened three times in 2004 in meetings that were open to the public and broadcast through the Board's Web site to make the discussions available to as wide an audience as possible. The agenda for each meeting was accompanied by publicly available briefing papers on the topics to be discussed.

The group's first meeting, on June 21 and 22, 2004, included discussions of the scope of the Board's standards-setting activities, the international convergence of auditing standards and coordination with standards-setters, and the prioritization and review of existing standards, including consideration of new standards. The attendees at the first meeting also discussed potential standards regarding engagement quality reviews of audits (also referred to as concurring or second partner reviews), quality control, and auditors' communications and relations with audit committees.

The Standing Advisory Group met again on September 8 and 9, 2004, and discussed issues relating to an auditor's responsibility for the detection of fraud, the interim auditing standard on related-party transactions, issues associated with auditing the measurement and disclosure of assets and liabilities at fair value, the interim auditing standard on the confirmation process, and risk assessment.

At their final meeting of the year, on November 17 and 18, 2004, the members of the Standing Advisory Group discussed, among other things, the codification of auditing standards, elements of quality control, reporting on the correction of material weaknesses, and the challenges of implementing the requirements of Section 404 of the Sarbanes-Oxley Act regarding companies' internal control over financial reporting.

Future Standards-Setting

At the Standing Advisory Group meeting on November 17, 2004, the Board sought advice on a series of topics for consideration as possible priorities in 2005 for auditing and related professional practice standards.

Among the topics that were presented for proposed professional standards are:

- Auditor independence and tax services;
- Detection of and reporting on financial fraud;
- The relative authority of auditing guidance in the Board's interim auditing standards;
- Communications with audit committees;
- Engagement quality review, also known as concurring or second partner review;
- Auditing related-party transactions;
- Consistency of application of generally accepted accounting principles;
- Use of confirmations in an audit;
- Auditing fair value measurements and disclosures;
- Elements of quality control for registered firms; and
- Assessing audit risk.

The priorities list was prepared by the PCAOB staff and presented to the Standing Advisory Group for input. Ultimately, the Board will decide which standards are proposed and at what time. Priorities could change if the Board or PCAOB staff identifies emerging issues that require attention. Although not all of these projects will be finalized in 2005, the Board expects that the PCAOB will make progress on each of them during the year.

Enforcement & Investigations

THE ABILITY TO INVESTIGATE POTENTIAL violations and to impose disciplinary sanctions against accounting firms and their associated persons is an important element of the authority given to the Board for the protection of investors. The Board has authority to impose sanctions when it determines that a registered accounting firm or one of its associated persons has violated the laws, rules, or standards within the Board's jurisdiction, or has failed reasonably to supervise another person with a view to preventing such violations.

The Board is empowered to impose a range of sanctions. At one end of the spectrum, Board sanctions may include such things as requiring additional professional training or requiring a firm to engage an independent monitor. For more serious misconduct, the Board may impose more severe sanctions, including suspending or barring an individual or a firm from performing audit work for public companies. The Board may also impose monetary penalties of as much as $750,000 per violation against an individual and $15 million per violation against a firm. Sanctions imposed by the Board may be appealed to the Securities and Exchange Commission, and the SEC's decision may be appealed to the U.S. courts of appeals.

In 2004, the Board established the Division of Enforcement and Investigations to carry out the Board's investigative and enforcement responsibilities. On May 14, 2004, the SEC approved the detailed rules that the Board had earlier adopted to govern its investigative and disciplinary processes and to provide fair procedures for the conduct of investigations, the conduct of hearings, and the imposition and termination of sanctions. Upon Commission approval, those rules took effect, allowing the Division to begin to pursue investigations with the full range of authority and tools provided by the Act.

Those tools are substantial. When the Board authorizes a formal investigation, the Division may demand that any registered firm, and any associated person of a registered firm, provide the Board with any testimony or documents relevant or material to the investigation. Failure to do so by a registered firm or associated person is an independent ground on which the Board may impose the full range of disciplinary sanctions on that firm or person. To obtain testimony or documents from any other person, the Division can seek the person's voluntary cooperation or can, under the Act, request that the SEC issue a subpoena to compel the testimony or document production in the Board's investigation.

The Division's investigations may grow out of information drawn from a variety of sources, including other regulators, PCAOB inspections of registered firms, public company reports of restatements or changes in auditor, news reports, and confidential tips. To encourage a flow of useful information, the Board established, in August 2004, its online "PCAOB Center for Enforcement Tips, Complaints, and Other Information," as well as a toll-free telephone number. These avenues make it easy for individuals to provide the Board with information concerning any matter relating to the Board and its work under the Act, including potential violations within the Board's disciplinary authority.

The Board's investigations are, by law, confidential and nonpublic. Pursuant to the Act and the Board's rules, however, the Division routinely coordinates and shares information with the SEC's Division of Enforcement. In appropriate circumstances, information gathered in Board investigations may also be shared with the U.S. Department of Justice, certain federal banking regulators, state attorneys general, and appropriate state regulatory authorities.

Financial Review

Public Company Accounting Oversight Board
Year Ended December 31, 2004

The year 2004 was the second operating year for the Public Company Accounting Oversight Board. In 2003, its first operating year, the Board identified the key activities that would allow it to fulfill its mission to protect the interests of investors and further the public interest in the preparation of informative, fair, and independent audit reports.

Much of the hiring and infrastructure construction required to support those key activities commenced in the second half of 2003 and continued in 2004. As a result, the PCAOB's 2004 financial statements reflect the first year of full operations and staffing of many of the PCAOB's activities. The financial statements also reflect significant ongoing investments in technology and hiring necessary for the Board to continue to fulfill its mandate under the Sarbanes-Oxley Act of 2002.

Each year, the PCAOB develops an operating budget that must be approved by the Securities and Exchange Commission, as required by the Sarbanes-Oxley Act of 2002. On November 25, 2003, the Board adopted a 2004 budget of approximately $103 million, which was approved by the SEC on February 20, 2004.

STATEMENTS OF FINANCIAL POSITION

The PCAOB financial statements have been prepared in accordance with U.S. generally accepted accounting principles and are presented pursuant to Statement of Financial Accounting Standards No. 117, *Financial Statements of Not-for-Profit Organizations* (SFAS No. 117). In accordance with SFAS No. 117, the net assets of the PCAOB are not subject to restrictions and therefore all have been classified as unrestricted in the financial statements. The PCAOB's unrestricted net assets for 2003 and 2004 primarily consist of its investments in fixed assets, especially technology hardware and software, and amounts to fund operations in the subsequent year prior to collection of that year's accounting support fees.

Cash and Cash Equivalents

Cash and cash equivalents include demand deposits with financial institutions and short-term, highly liquid investments. The PCAOB utilizes a sweep service from a financial institution to invest daily in overnight repurchase agreements, typically in U.S. Treasury or agency issues.

Cash and cash equivalents also include cash collected on behalf of the Financial Accounting Standards Board. The Financial Accounting Foundation (FAF) designated the PCAOB as the collection agent for invoicing and collection of the 2003 and 2004 FASB accounting support fees, as authorized by the Sarbanes-Oxley Act. In August 2003, the PCAOB issued invoices for the FASB's 2003 accounting support fee of approximately $25 million. The cash and cash equivalents for 2003 include approximately $304,000 of cash collected on behalf of FASB at December 31, 2003. A corresponding amount of approximately $304,000 is included in accounts payable and other liabilities for amounts due to the FASB at December 31, 2003. In February 2004, the PCAOB issued invoices for FASB's accounting support fee totaling approximately $25 million. The cash and cash equivalents for 2004 include approximately $19,000 of cash collected on behalf of FASB at December 31, 2004. The decrease from 2003 to 2004 reflects the timing of the invoices in 2003 versus 2004. A corresponding amount of approximately $19,000 is included in accounts payable and other liabilities for amounts due to the FASB on December 31, 2004. The PCAOB earned and was paid approximately $210,000 in each year for acting as FASB's billing and collection agent.

Accounts Receivable and Other Receivables

The majority of accounts receivable and other receivables of approximately $207,000 at December 31, 2004, are amounts due from landlords relating to tenant improvements. Accounts receivables for uncollected accounting support fees were approximately $33,000 on December 31, 2004.

As of December 31, 2003, accounts receivable and other receivables totaled approximately $2.2 million and were composed almost entirely of uncollected accounting support fees. Approximately $1.4 million of this amount was due from approximately 430 issuers of American Depository Receipts that were assessed incorrect accounting support fees due to errors in the market capitalization figures used to calculate their fees. The PCAOB withdrew the initial invoices on August 27, 2003, and issued new invoices as part of the billing cycle for the 2004 accounting support fee. Because the fees originally assessed to the 430 issuers were higher than they should have been, the errors effectively reduced the PCAOB's 2003 anticipated revenue by approximately $15.5 million and had the effect of reducing the share of the accounting support fee billed and collected from all other issuers subject to the fee by that amount.

Prepaid Expenses and Other Assets

Prepaid expenses and other assets of approximately $941,000 and $635,000 at December 31, 2004, and 2003, respectively, consist primarily of cash paid in advance for rent, insurance, maintenance contracts, and data and media subscriptions.

Furniture and Equipment, Leasehold Improvements, and Technology

During 2004 and 2003, the PCAOB invested approximately $17 million and $19 million, respectively, in furniture and equipment, leasehold improvements, and information technology to build the infrastructure of the organization. As of December 31, 2004, the PCAOB had established its Washington, D.C. headquarters and four regional offices in New York City, Atlanta, Dallas, and San Francisco, in addition to a Northern Virginia office for its information technology group. The Board approved additional regional offices and hired personnel for Orange County (California), Chicago, and Denver locations. These offices are expected to be operational in 2005.

The PCAOB's investment in technology, furniture, and leaseholds continues to reflect the development of operational infrastructure, telecommunications, security, and software. Software acquisition is a mixture of commercial off-the-shelf products and certain specific propriety applications. For each proprietary system, the PCAOB considered the costs and benefits of making or buying the system, taking into account the cost, technology, use, and security. In each instance, the PCAOB found that the benefits of building the system in-house outweighed the benefits of utilizing an existing system. The following chart reflects capital expenditures for 2004 and 2003:

Capital Expenditures

	2004	2003
Technology—program activities	$ 8,874,000	$ 4,878,000
Technology—supporting activities	6,714,000	9,053,000
Furniture and leasehold improvements	1,766,000	5,168,000
Total	$17,354,000	$19,099,000

Accounts Payable and Other Liabilities

Accounts payable and other liabilities for both years are mostly made up of year-end accruals. The increase in 2004 is related to an increase in trade payables and liabilities arising from increased headcount.

STATEMENTS OF ACTIVITIES

Operating Revenue

The PCAOB's operations are funded by accounting support fees assessed annually on issuers based on a methodology described in the Sarbanes-Oxley Act and PCAOB rules, as approved by the Securities and Exchange Commission.

The accounting support fees, or "fees from issuers" as reflected in the financial statements, are equal to the Board's budget for the calendar year in which they are set, less the amount of fees received in the prior year from public accounting firms or "fees from registering accounting firms."

Under the Act and the Board's rules, the annual accounting support fee is allocated to issuers based on the average monthly U.S. equity market capitalization of publicly traded companies, investment companies, and other equity issuers. However, issuers with average market capitalization of less than $25 million, and investment companies with net asset values of less than $250 million, are exempt from the fee.

In 2004, the PCAOB issued invoices to approximately 8,800 issuers, as compared to approximately 8,500 issuers in 2003. The PCAOB recorded approximately $101.1 million and approximately $52.9 million in 2004 and 2003, respectively, in accounting support fee revenue.

In 2004, approximately 51% of the issuers billed received invoices for $1,000 or less, and the largest 1,000 issuers received invoices for about 85% of the total fees. The accompanying chart reflects the distribution of fee levels by issuers.

Assessment of Accounting Support Fees

	Number of Issuers	
FEES	2004	2003
$100–500	2,996	4,244
$501–1,000	1,457	1,094
$1,001–5,000	2,461	1,911
$5,001–10,000	707	472
$10,001–50,000	863	536
$50,001–100,000	170	75
$100,001–500,000	136	80
$500,001–1,000,000	21	8
$1,000,001+	10	4
Total	8,821	8,424

Combined, publicly traded companies contributed about 95% of the total fees paid in 2004, while open-end mutual funds provided about 4.6%, and other investment companies paid the remainder.

In addition to the annual accounting support fee, the Board receives registration fees from public accounting firms seeking to register with the Board pursuant to Section 102 of the Sarbanes-Oxley Act and PCAOB rules. Accounting firms seeking to register with the Board are required to pay fees based on each firm's number of public company audit clients. The fees range from $250 for a firm with no public company audit clients to $390,000 for a firm with more than 1,000 public company audit clients.

U.S.-based accounting firms were required to register with the Board by October 22, 2003, in order to continue auditing public company clients. By December 31, 2003, 735 firms—including four firms with more than 1,000 public company audit clients each—had registered with the Board, and the fees from those registering accounting firms totaled a little more than $2 million.

Accounting firms based outside the United States were required to register with the Board by July 19, 2004, in order to continue auditing public company clients. During 2004, the Board registered 530 non-U.S. accounting firms and 158 U.S. accounting firms. In general, these firms have fewer public company clients that are required to file audited financial statements with the SEC. As a result, the total collected from registration applicants in 2004 was approximately $304,000.

Operating Expenses

Program Activities

The Sarbanes-Oxley Act gives the PCAOB four primary responsibilities to carry out its mission: registration, inspections, standards-setting, and enforcement. These responsibilities are designated as program activities for the PCAOB and are so reflected in the financial statements. The 2004 financial statements also reflect certain reclassifications and additions to the PCAOB's program descriptions, representing the progression of the organization from its start-up stage to a more mature operation. For example, registration and inspections are paired in one program activity to reflect that those programs are carried out by the Board's Division of Registration and Inspections. Enforcement is identified in the financial statements as a separate program activity because its activities are carried out as a separate operating unit. Board and related activities have been reclassified from a supporting activity to a program activity, reflecting the Board's focus on its official regulatory responsibilities under the Act. The newly created function of Financial Analysis and Risk Assessment is designated as a program activity.

Costs associated with these programs include salaries, benefits, rent, program-specific technology costs, and other direct operating expenses relating to the specific activity. For the majority of the program activities, the costs in 2003 reflected less than a full year of staffing and program operations and are, in some cases, substantially lower than the costs in 2004.

Registration and Inspections

During 2004, the Board continued to register public accounting firms. The number of public accounting firms that are registered grew from 735 firms as of December 31, 2003, to 1,423 firms as of December 31, 2004. Most of this growth came from the registration of non-U.S. firms based in 76 countries. Also during 2004, the PCAOB continued to develop and enhance the Web-based registration system.

In 2004, the Board began its program of conducting full inspections of certain domestic registered public accounting firms, including the eight largest U.S. firms, which require annual inspections. The Board embarked on and continued an aggressive recruiting effort to hire experienced auditors to conduct inspections. During 2004, the inspections staff increased from 44 inspectors in five domestic offices to 120 inspectors in seven domestic offices. The significant increase in program costs from 2003 to 2004 directly relates to an increase in headcount and the number of inspections performed in 2004. The increase also reflects the opening of new regional offices and the travel costs associated with on-site inspections of 99 registered accounting firms.

Standards-Setting

In 2004, the Board adopted the first three auditing standards developed by the Office of Chief Auditor, which was formed to advise and assist the Board in fulfilling its mandate to set standards for auditing and related attestations, quality control, ethics, and independence for the audits of public companies. During 2004, the Office of Chief Auditor increased from nine employees to 12. The increase in program costs from 2003 is attributable to the increase in staff and a full year of operations for standards-setting, including the first three meetings of the Board's Standing Advisory Group.

Enforcement

During 2004 the Division of Enforcement and Investigations began to accelerate its development with the hiring of a Director. The group grew from two employees in 2003 to nine by year end 2004.

Financial Analysis and Risk Assessment

In 2004, the Board began investing in a financial analysis and risk assessment function to collect, analyze, and assimilate information from multiple sources and provide the Board and its staff with assessments of risks related to the financial reporting process. The 2004 program costs supported infrastructure and staff for financial analysis and risk assessment. The staff numbered six by December 31, 2004.

Board and Related Activities

During 2004, the Board and related activities stayed fairly consistent in headcount and operating costs. The increase in 2004 is mostly attributable to a full year of operations for the Board and its staff and for international initiatives, including meetings with non-U.S. regulators of public accounting firms in furtherance of the Board's mission to oversee non-U.S. accounting firms that audit public companies.

Supporting Activities

Supporting activities continue to make up a significant percentage of the PCAOB's 2004 operating expenses. During 2004, the PCAOB continued to build the corporate infrastructure to support the program areas. Supporting activities comprise three areas: administration and general; communications; and IT infrastructure, security and telecommunications. Similar to program activities in 2003, the majority of the supporting activities commenced in mid 2003, and amounts expended in 2004 represent the full year of operations.

Administration and General

Administration and general expenses include indirect costs relating to program activities in addition to operating costs for the following areas: Administration, Finance, General Counsel, Human Resources, and Internal Oversight and Performance Assurance (IOPA). Headcount for these areas increased from 32 employees at December 31, 2003, to 43 at December 31, 2004. The increase in headcount is mostly attributable to an increase in the Office of General Counsel and the creation of the Office of IOPA in early 2004. IOPA was created by the Board to provide internal examination of the programs and operations of the PCAOB to help ensure the efficiency, effectiveness, and integrity of those activities. The increase in costs for these activities from 2003 to 2004 relate directly to the increase in headcount and a full year of operations for all of the areas.

Communications

Communications includes the operating costs for the government relations and public affairs offices. The increase in costs for these activities from 2003 to 2004 relates directly to full staffing and a full year of operations for both offices.

IT Infrastructure, Security, and Telecommunications

IT infrastructure, security, and telecommunications include related headcount and depreciation associated with capital expenditures that are not directly attributable to program activities. The increase is related to the support of the overall increase in the PCAOB's total headcount, the addition of regional offices, and full year operations in a number of program areas.

Interest Income and Other

The increase in interest income from 2003 to 2004 is attributed to the increase in the average monthly cash balance held in 2004 due to the timing and amount of 2004 invoices.

Statements of Financial Position

Public Company Accounting Oversight Board
December 31, 2004 and 2003

	2004	2003
Assets		
Cash and cash equivalents (Note 2)	$40,654,476	$14,984,233
Accounts receivable and other receivables	207,243	2,193,903
Prepaid expenses and other assets	941,440	635,420
Furniture and equipment, leasehold improvements and technology, net (Note 3)	25,543,450	16,430,878
Total Assets	$67,346,609	$34,244,434
Liabilities and Net Assets		
Liabilities		
Accounts payable and other liabilities	$ 6,893,395	$ 5,417,498
Deferred rent (Note 4)	3,542,970	3,028,134
Total Liabilities	10,436,365	8,445,632
Net Assets		
Unrestricted	56,910,244	25,798,802
Total Net Assets	56,910,244	25,798,802
Total Liabilities and Net Assets	$67,346,609	$34,244,434

The accompanying notes are an integral part of these financial statements.

Statements of Activities

Public Company Accounting Oversight Board
Years Ended December 31, 2004 and 2003

	2004	2003
Changes in Unrestricted Net Assets		
Operating Revenue		
Fees from issuers (Note 2)	$101,093,100	$52,851,530
Fees from registering accounting firms (Note 2)	304,000	2,038,500
Total operating revenue	101,397,100	54,890,030
Operating Expenses		
Program activities (Note 2)		
Registration and inspections	31,058,656	10,242,309
Enforcement	1,901,298	152,582
Standards-setting	3,636,440	1,653,659
Financial analysis and risk assessment	918,744	—
Board and related activities	6,874,092	5,326,412
Supporting activities		
Administration and general	10,556,050	6,519,636
Communications	2,022,850	910,749
IT infrastructure, security and telecommunications	13,983,052	4,619,068
Total operating expenses	70,951,182	29,424,415
Operating Income	30,445,918	25,465,615
Interest Income and Other	665,524	333,187
Increase in Unrestricted Net Assets	31,111,442	25,798,802
Unrestricted Net Assets, Beginning of Year	25,798,802	—
Unrestricted Net Assets, End of Year	$ 56,910,244	$25,798,802

The accompanying notes are an integral part of these financial statements.

Statements of Cash Flows

Public Company Accounting Oversight Board
Years Ended December 31, 2004 and 2003

	2004	2003
Cash Flows from Operating Activities		
Cash received from issuers	$103,015,503	$ 50,895,673
Cash received from registering accounting firms	304,847	2,032,250
Interest income and other	665,524	333,187
Cash paid to suppliers and employees	(60,961,046)	(19,177,792)
Net cash provided by operating activities	43,024,828	34,083,318
Cash Flows from Investing Activities		
Purchases of furniture and equipment, leasehold improvements and technology	(17,354,585)	(19,099,085)
Cash Flows from Financing Activities		
Advances	—	20,342,000
Repayment of advances	—	(20,342,000)
Net cash provided by (used in) financing activities	—	—
Net Increase in Cash and Cash Equivalents	25,670,243	14,984,233
Cash and Cash Equivalents, Beginning of Year	14,984,233	—
Cash and Cash Equivalents, End of Year	$ 40,654,476	$ 14,984,233
Reconciliation of Income in Unrestricted Net Assets to Net Cash Provided by Operating Activities:		
Increase in Unrestricted Net Assets	$ 31,111,442	$ 25,798,802
Reconciliation Adjustments		
Depreciation and amortization	8,242,013	2,668,207
Decrease (increase) in accounts receivable	1,986,660	(2,193,903)
Increase in prepaid expenses	(306,020)	(635,420)
Increase in accounts payable, accrued expenses and employee benefit accruals	1,475,897	5,417,498
Increase in deferred rent	514,836	3,028,134
Net Cash Provided by Operating Activities	$ 43,024,828	$ 34,083,318

The accompanying notes are an integral part of these financial statements.

Notes to the Financial Statements

Public Company Accounting Oversight Board
December 31, 2004 and 2003

NOTE 1—NATURE OF ACTIVITIES

The Public Company Accounting Oversight Board (the "PCAOB") was established by the Sarbanes-Oxley Act of 2002 (the "Act") 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. The Act established the PCAOB as a private, non-profit corporation.

Under the Act, the PCAOB is overseen by the U.S. Securities and Exchange Commission (the "SEC"). The Board's rules and standards are filed with the SEC and do not take effect unless approved by the SEC. In addition, the PCAOB's budget must be approved by the SEC, and the SEC must approve the PCAOB's bringing or defending litigation in any federal, state or other court. Finally, the Act directs the SEC to appoint the members of the PCAOB's Board, after consultation with the chairman of the Board of Governors of the Federal Reserve System and the Secretary of the Treasury, and gives the SEC authority, as appropriate, to rescind the PCAOB's Board authority and censure or remove individual PCAOB Board members. In its oversight role, the SEC determined on April 25, 2003 that the PCAOB had the capacity to discharge its responsibilities and enforce compliance with the Act.

NOTE 2—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Presentation. The financial statements have been prepared in accordance with U.S. generally accepted accounting principles and are presented pursuant to Statement of Financial Accounting Standards Statement No. 117, *Financial Statements of Not-for-Profit Organizations* ("SFAS No. 117"). Under SFAS No. 117, the PCAOB is required to report information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets. The net assets of the PCAOB are not subject to restrictions and therefore all have been classified as unrestricted in the accompanying statements.

The PCAOB's unrestricted net assets primarily consist of its investments in technology and amounts to fund operations in the subsequent year prior to collection of that year's funding. Registration and inspections, enforcement, standards-setting, financial analysis and risk assessment and board and related activities are the program activities for the PCAOB. Costs associated with these program activities include salaries, benefits, rent, program-specific technology costs and other direct operating expenses relating to the above activities. Indirect costs are not allocated to program activities, but are included in supporting activities.

Program Activities of the PCAOB

- ***Registration and Inspections.*** The Act requires that an accounting firm be registered with the PCAOB if it prepares or issues, or plays a substantial role in the preparation or issuance of, any audit report with respect to an issuer. The PCAOB reviews the registration application of each public accounting firm that chooses to register with it. If the PCAOB approves its application, that registered public accounting firm is subject to the PCAOB's continuing program of inspections. This program assesses each firm's compliance with the Act, the rules of the PCAOB and the rules of the SEC and professional standards, in connection with the firm's performance of audits, issuance of audit reports, and related matters involving issuers, as defined in the Act.
- ***Enforcement.*** The Act grants the PCAOB broad investigative authority over registered public accounting firms and persons associated with such firms. The PCAOB has authority to impose disciplinary sanctions when it determines that one or more of the above has violated the laws, rules, or standards within the PCAOB's jurisdiction.
- ***Standards-Setting.*** The PCAOB establishes auditing, related attestation, quality control, independence and ethics standards to be used by registered public accounting firms in the preparation and issuance of audit reports.

- ***Financial Analysis and Risk Assessment.*** The PCAOB established the Office of Financial Analysis and Risk Assessment to collect, analyze, and assimilate information from multiple sources and provide the PCAOB with assessments of risks that may influence public companies or their auditors to provide financial statements or other public information that is not fairly presented in all respects.
- ***Board and Related Activities.*** In accordance with the Act, the PCAOB Board is responsible for carrying out the PCAOB's regulatory programs and operations. Although the PCAOB Board has established an experienced professional staff in each of its program areas, the PCAOB Board remains responsible for determining the PCAOB's action in each program area, as well as for performing such other duties or functions as the PCAOB Board (or the SEC, by rule or order) determines are necessary or appropriate to promote high professional standards among, and improve the quality of audit services offered by, registered public accounting firms and their associated persons, or otherwise to carry out the Act, in order to protect investors or further the public interest. In addition, the PCAOB Board engages in communication and other outreach efforts with the accounting profession, the investing public, public companies, and other U.S. and non-U.S. regulators concerning, among other things, the PCAOB's mission, programs and initiatives and its oversight of the accounting profession. Also included in Board and Related Activities are the PCAOB's international initiatives.

Use of Estimates. The preparation of financial statements in accordance with U.S generally accepted accounting principles requires management to make estimates and assumptions that may affect the reported amounts of assets, liabilities, revenues, and expenses, and the disclosure of contingent assets and liabilities. Accordingly, actual results could differ from these estimates.

Fees from Issuers. Fees from issuers, which are referred to as the Board's Accounting Support Fee in the Act, are amounts invoiced to certain issuers whose shares are publicly traded and to certain investment companies to fund the operating budget of the PCAOB. Such fees are recognized as revenue in the budget year to which they relate. The amount of fees invoiced to individual entities is determined as prescribed in the Act and the Rules of the PCAOB. The PCAOB reports all fees from issuers as an increase in unrestricted net assets.

Fees from Registering Accounting Firms. Fees from registering accounting firms are amounts collected from each public accounting firm that applies for registration with the PCAOB to recover the costs of processing and reviewing registration applications. These fees are not intended to and do not cover certain registration program expenditures that do not relate solely to processing and reviewing registration applications. The PCAOB reports all fees from registering accounting firms as an increase in unrestricted net assets and all such fees are recognized as revenue in the budget year to which they relate.

Cash Held for Others under Agency Agreement. On behalf of the Financial Accounting Standards Board (the "FASB"), the Financial Accounting Foundation (the "FAF") designated the PCAOB as the collection agent for invoicing and collection of the 2004 and 2003 FASB accounting support fees. The PCAOB earned and was paid $209,400 in both 2004 and 2003 from FAF for acting as the collection agent. This amount is included in interest income and other in the accompanying statements of activities. Otherwise, the PCAOB recognizes no revenue or expense related to this relationship and maintains a separate bank account for all fees collected on behalf of the FASB. As of December 31, 2004 and 2003, the PCAOB had $19,418 and $304,131, respectively, included in cash and cash equivalents related to the FASB. A corresponding $19,418 and $304,131 was included in accounts payable and other liabilities for amounts due to the FASB as of December 31, 2004 and 2003, respectively.

Cash and Cash Equivalents. The term cash and cash equivalents, as used in the accompanying financial statements, includes demand deposits with financial institutions, and short-term, highly liquid investments purchased with a maturity of three months or less. At times, the PCAOB's demand deposits with financial institutions exceed federally insured limits. However, the PCAOB has not experienced any losses in such accounts and management believes the PCAOB is not exposed to any significant credit risk on these accounts.

Depreciation and Amortization. Furniture and equipment, leasehold improvements and technology are stated at cost, less accumulated depreciation and amortization computed under the straight-line method over their useful lives. Furniture and equipment and technology are depreciated over their estimated useful lives of 3 to 5 years. Leasehold improvements are amortized over the shorter of their estimated useful lives or the remaining term of the current office leases.

Taxes. The PCAOB is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code. Therefore the accompanying financial statements include no provision for federal income taxes. It is the PCAOB's position that because of its status and powers under the Act it is not subject to state and local taxation. The PCAOB has made filings with appropriate state and local taxing authorities to receive formal tax exemptions, where available. In those circumstances where the PCAOB has not received a formal tax exemption and any possible tax liability would be significant, it will take appropriate steps to establish that it is not subject to state and local taxes in the relevant jurisdiction, pursuant to the Act.

Reclassifications. Certain amounts in the 2003 financial statements have been reclassified to conform with the current year's presentation.

NOTE 3—FURNITURE AND EQUIPMENT, LEASEHOLD IMPROVEMENTS AND TECHNOLOGY

These assets consist of the following at December 31, 2004 and 2003:

	2004	2003
Technology		
Hardware	$ 11,577,336	$ 4,121,240
Purchased and developed software	17,873,912	9,809,235
Leasehold improvements	3,476,906	2,598,037
Furniture and equipment	3,056,627	2,570,573
Total	35,984,781	19,099,085
Accumulated depreciation and amortization	(10,441,331)	(2,668,207)
	$ 25,543,450	$16,430,878

Depreciation and amortization expense was $8,242,013 and $2,668,207 in 2004 and 2003, respectively.

NOTE 4—LEASE COMMITMENTS

As of December 31, 2004, the PCAOB occupied office space in Washington, DC, New York, New York, Sterling, Virginia, San Mateo, California, Atlanta, Georgia, and Dallas, Texas on leases that expire from 2006 to 2014. The leases include provisions for scheduled rent increases over the respective terms.

Rent is being expensed using the straight-line method over the respective lease terms. Rent under this method was $3,097,378 and $2,342,617 in 2004 and 2003, respectively. Deferred rent that has been expensed but will not be paid until future years totaled $3,542,970 and $3,028,134 as of December 31, 2004 and 2003, respectively, and is being amortized over the remaining lives of the office leases.

Minimum rental commitments under the office leases as of December 31, 2004 are as follows:

YEAR ENDING DECEMBER 31,	
2005	$ 3,817,688
2006	4,176,515
2007	3,780,828
2008	3,861,140
2009	3,938,216
Thereafter	15,477,669
Total	$35,052,056

NOTE 5—RETIREMENT BENEFIT PLAN

The PCAOB has a defined contribution retirement plan which covers active employees. The PCAOB matches contributions in an amount equal to 100% up to 6% of the eligible compensation. The PCAOB's contributions become fully vested immediately. The PCAOB's contributions to employees' accounts were approximately $1,496,782 and $412,152 for 2004 and 2003, respectively.

NOTE 6—2003 ADVANCES FROM THE DEPARTMENT OF THE TREASURY

In accordance with the Act, the PCAOB was advanced funds to cover its start-up expenses from The Department of the Treasury totaling $20,342,000 during 2003. These advances were repaid on September 22, 2003.

NOTE 7—SUBSEQUENT EVENTS

In January 2005, the PCAOB entered into a ten-year operating lease in Ashburn, Virginia commencing on April 1, 2005 and ending March 31, 2015. Minimum rental commitments under this lease total $3,551,547. The new space will supersede the Sterling, Virginia location for which the related lease will terminate upon occupancy of the Ashburn location. Once occupied, the PCAOB's minimum rental commitments will be reduced by $865,050 from that reflected in the table in Note 4.

Independent Auditors' Report

Public Company Accounting Oversight Board

To the Board of the Public Company Accounting Oversight Board
Washington, DC

We have audited the accompanying statements of financial position of the Public Company Accounting Oversight Board (the PCAOB) as of December 31, 2004 and 2003, and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of the PCAOB's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with U.S. generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Public Company Accounting Oversight Board as of December 31, 2004 and 2003, and the changes in its net assets and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Beers & Cutler PLLC

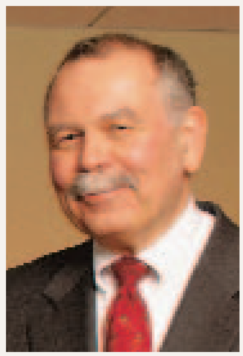
Washington, DC
February 16, 2005

PCAOB

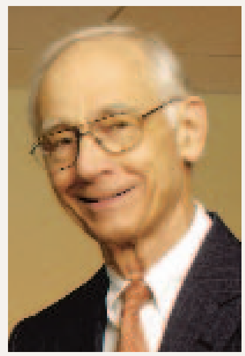
Public Company Accounting Oversight Board

William J. McDonough
Chairman

Kayla J. Gillan
Board Member



Daniel L. Goelzer
Board Member



Bill Gradison
Board Member

Charles D. Niemeier
Board Member

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