

A blurred photograph of two business professionals, a man and a woman, walking in a hallway. The man is wearing a dark suit and the woman is wearing a grey skirt and black heels. They are carrying briefcases and papers. The background is a dark red wall with vertical wood paneling.

# PCAOB

Public Company Accounting Oversight Board

Committed to  
Investor Protection

PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD 2010 ANNUAL REPORT



# Mission

The PCAOB mission is to oversee the audits of public companies in order to protect the interests of investors and further the public interest in the preparation of informative, accurate and independent audit reports. The PCAOB also oversees the audits of broker-dealers, including compliance reports filed pursuant to federal securities laws, to promote investor protection.

# PCAOB

Public Company Accounting Oversight Board

## From the Chairman

I am pleased to present this report on the work of the Public Company Accounting Oversight Board in 2010.

Through inspections, standard setting and enforcement, the PCAOB actively engaged public company auditors in 2010 in an effort to improve the quality of audits and build investors' confidence in the financial reporting of the companies that seek capital in U.S. markets.

The accomplishments described in this report reflect the dedication and inspiration of a remarkable staff, now more than 600 strong, who demonstrate daily their commitment to strengthening the reliability of audits.

## From the Chairman

Credit for these accomplishments is due to the members of the Board who led the PCAOB in 2010: Bill Gradison, Steven B. Harris, Charles D. Niemeier and Acting Chairman Daniel L. Goelzer.

Messrs. Goelzer, Gradison and Niemeier were among the first Board members appointed by the Securities and Exchange Commission to lead the PCAOB after its creation by the Sarbanes-Oxley Act of 2002. Their foresight and labor made a reality of the dynamic oversight program envisioned by the Act.

Until the PCAOB began operations in January 2003, the auditing profession was self-regulated. The accounting profession wrote the standards and relied on peers to gauge the quality of firms' work.

In 2002, in response to the collapse of major corporate enterprises and staggering investor losses, the Sarbanes-Oxley Act vested audit-firm regulation, including standard-setting authority and a system for independent assessment of the performance of auditors, in the PCAOB. The new Board was required to register accounting firms that audit, or play a substantial role in auditing, the financial statements of public companies traded in U.S. markets.

The founding Board members turned to George Diacont to form the PCAOB's Division of Registration and Inspections. Under the leadership of Mr. Diacont, the PCAOB built from scratch a world-class inspection program that now employs more than 340 talented and experienced staff members.

Mr. Diacont retired in early March 2011. Messrs. Gradison and Niemeier completed their service on Jan. 31, 2011. They will be missed as colleagues, but their insights, their creativity and, most of all, their belief in the primacy of investors' interests underpin the continuing work of the PCAOB. Their legacy will be clear as

we enter the ninth year of performing independent inspections of accounting firms and their audits.

The auditing profession is also the inheritor of a distinguished tradition—objectivity and independence constituting the core strength of that tradition. We will push the auditors to uphold those values and to regain them when they are compromised.

PCAOB inspectors continue to identify problems in audits conducted by each of the large accounting firm networks and in other firms that audit public company financial statements. In many cases, our inspectors find no deficiencies in the portions of an audit that they review. Many of the problems identified are in areas of significant judgment such as valuation of investments and testing assets for impairment. Those problems are being addressed through additional inspections, standard setting, audit practice alerts, direct discussions with audit firm leaders and, when necessary, disciplinary action.

I joined the PCAOB on Feb. 1, 2011. I took this job because I wanted to be part of an organization that responds vigorously to risks facing the investing public. I knew that the PCAOB strives to maintain a culture focused on excellence in the pursuit of the public interest, and I welcomed the opportunity to help lead the PCAOB in that endeavor.

The Board members who preceded me set the foundation for an oversight program that relies on robust engagement with investors, public companies, other standard-setting bodies and auditors. I intend to continue that engagement.

The PCAOB is fortunate to count among its resources some of the smartest, most mission-focused people I have ever had the pleasure to work with. I count among them Messrs. Goelzer and



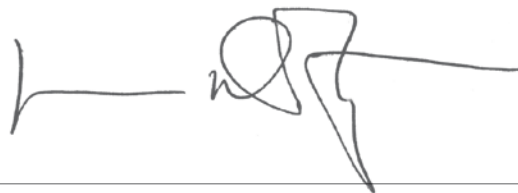
Harris, whose service on the Board continues, and my new colleagues, Board members Lewis H. Ferguson and Jay D. Hanson.

I will close with special thanks to Dan Goelzer, who served more than 18 months as acting chairman of the PCAOB. In less than a handful of months on the job, I have developed special appreciation for his work and that of my predecessors, William J. McDonough and Mark W. Olson, at the helm of this remarkable organization.

Among the hallmarks of Dan's service were his focus on high quality standard setting and his request for Congress to lift the confidentiality provisions that shroud PCAOB actions to stop the worst auditing practices. I wholeheartedly endorse this request. As acting chairman, Dan also shepherded the interests of the PCAOB and the public during the consideration and passage of the Dodd-Frank Act.

The Dodd-Frank Act is an important milestone for the PCAOB, expanding the Board's ability to protect investors. It provided new authority for PCAOB oversight of the auditors of SEC-registered brokers and dealers, and it empowered the Board to share information with non-U.S. audit regulators, clearing an impediment to inspections of some non-U.S. firms.

With the continuing support of SEC Chairman Mary Schapiro and her colleagues on the Commission and SEC staff, I am confident the PCAOB will meet the challenges of this landmark legislation as we continue our efforts to further the public interest in the preparation of informative, accurate and independent audit reports.



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**James R. Doty**, *Chairman*  
*Public Company Accounting Oversight Board*  
Washington, D.C.  
May 2011



# Overview

*The Public Company Accounting Oversight Board was created by the Sarbanes-Oxley Act of 2002 to protect the interests of investors and further the public interest in the preparation of informative, accurate and independent audit reports. To accomplish its mission, the PCAOB oversees the auditors of public companies, as well as the auditors of brokers and dealers, through registration, inspection, enforcement and standard setting.*

In 2010, the Board focused significant attention on issues related to the ongoing effects of the financial crisis and obstacles that prevented PCAOB inspections of certain non-U.S. accounting firms that conduct or participate in audits of companies trading in U.S. markets. The Board also confronted the implications of nonpublic PCAOB disciplinary proceedings, which enable accounting firms to continue performing audits without public notice of pending charges.

These issues raised concerns about the vulnerability of investors. The Board responded with special alerts to auditors, highlighting relevant PCAOB standards to guide their work in light of risks and challenges identified in connection with the disruption in credit and financial markets and the broader economic downturn. The Board continued its practice of disclosing the progress made in conducting inspections of non-U.S. firms and provided additional disclosure about the U.S.-traded companies whose non-U.S. auditors could not be inspected because of home country objections. The Board also asked Congress to amend the Sarbanes-Oxley Act to provide for public disciplinary proceedings.

Finally, the Board took steps to implement the provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which became law July 21, 2010. The Dodd-Frank Act gave the PCAOB new responsibilities for the oversight of auditors of SEC-registered brokers and dealers, including standard-setting, inspection and disciplinary authority.

## Registration

The number of accounting firms registered with the PCAOB grew slightly in 2010. At the end of the year, 2,397 firms were registered with the PCAOB, including 1,503 domestic firms and 894 non-U.S. firms located in 86 jurisdictions.

In 2010, registered firms began filing annual reports and special reports on certain events.

## Inspections

In 2010, the PCAOB conducted inspections of nine public accounting firms that performed more than 100 audits of public companies traded in U.S. markets. Inspectors examined portions of more than 350 audits performed by these firms. The PCAOB also inspected 245 firms with 100 or fewer public company audit clients, including 64 non-U.S. firms located in 20 jurisdictions. In the course of those inspections, PCAOB staff examined portions of more than 600 audits.

## Standards

In 2010, the Board adopted a suite of eight standards related to the assessment of and response to risk in an audit. The standards address many fundamental aspects of the audit, from the initial planning stages through the evaluation of audit results.

Continued fallout from the financial crisis, as well as an increase in certain non-U.S. companies seeking capital in U.S. markets, prompted the PCAOB to alert auditors to existing standards relating to public companies' use of unusual transactions; disclosure of potential liabilities related to mortgages and foreclosures; and

reliance on the work of other firms or assistants engaged from outside the firm, including those based in non-U.S. jurisdictions, where the PCAOB may be barred from inspecting firms.

The Board also proposed new standards for confirmation procedures by auditors and for communications with audit committees. In 2010, the Board laid the groundwork for possible changes to the auditor's report. PCAOB staff began a comprehensive outreach program to gather information from investors, preparers, issuers and auditors about the content and format of audit reports and the implications of potential changes.

## Enforcement

In 2010, the Board initiated 15 formal investigations, conducted a number of informal inquiries and continued investigations that began in prior years. At the end of December 2010, the PCAOB was engaged in 23 formal investigations. PCAOB investigations are, by law, confidential and nonpublic.

The Board issued seven settled disciplinary orders in 2010, imposing sanctions ranging from censures to bars on association with registered accounting firms, as well as monetary penalties. Other disciplinary proceedings were approved by the Board in 2010 and are in active litigation. Unlike similar auditor proceedings brought by the SEC, Board disciplinary proceedings are nonpublic as required by the Sarbanes-Oxley Act.

## SEC Oversight

The Sarbanes-Oxley Act gives the Securities and Exchange Commission oversight authority over the PCAOB.

The PCAOB is subject to rules and orders promulgated by the SEC. PCAOB rules, including its auditing and related professional practice standards, are not effective unless approved by the SEC. As provided in the Sarbanes-Oxley Act, adverse PCAOB inspection reports, remediation determinations and disciplinary actions against registered firms and their associated persons are subject to review by the SEC.

The SEC also is responsible for approving the PCAOB's annual budget, which, for 2010, was \$183.3 million. As provided by the Sarbanes-Oxley Act, the PCAOB's 2010 budget was funded primarily through an annual accounting support fee assessed on public companies in proportion to their respective average monthly market capitalizations. The PCAOB receives no federal appropriations.

The SEC is responsible for appointing and removing Board members. In 2010, litigation that raised a constitutional challenge to the framework for the appointment and removal of Board members was resolved with a ruling by the U.S. Supreme Court in *Free Enterprise Fund v. PCAOB*.

On June 28, 2010, the Supreme Court held that the Sarbanes-Oxley Act's provisions making Board members removable by the SEC only for good cause were inconsistent with the Constitution's separation of powers. Because the Court severed these provisions from the Sarbanes-Oxley Act, however, no legislation was necessary to bring the Board's structure within constitutional requirements. The consequence of the Court's decision is that PCAOB Board members are removable by the SEC at will, rather than only for good cause. All other aspects of the SEC's oversight, the structure of the PCAOB and its programs were otherwise unaffected by the Court's decision.

On Jan. 7, 2011, the SEC appointed three new Board members to the PCAOB: Chairman James R. Doty, Lewis H. Ferguson and Jay D. Hanson. They joined Steven B. Harris and Daniel L. Goelzer, who served as acting chairman throughout 2010.

# Registration

No accounting firm may prepare, or play a substantial role in preparing, an audit report for a public company or SEC-registered broker or dealer without being registered with the PCAOB. At the end of 2010, there were 2,397 firms registered with the PCAOB, including 1,503 domestic firms and 894 non-U.S. firms located in 86 jurisdictions.

The public accounting firms registered with the PCAOB vary in size, ranging from sole proprietorships to large audit firms that are members of extensive global networks, comprising numerous separately registered accounting firms.

In 2010, the Board considered and approved registration applications of 308 accounting firms, including 60 non-U.S. firms. The Board also disapproved nine registration applications by disciplinary orders, according to the process established by the Sarbanes-Oxley Act and the Board's rules. The Board considered and granted 249 requests to withdraw from registration in 2010, as compared to 69 such requests in 2009.

In 2010, under the Board's new reporting framework, registered firms filed annual reports for the first time. In its annual report, each firm is required to disclose information about its issuer-related practice; internal and external resources on which the firm draws in performing audits; and certain new relationships and acquisitions. The annual report also requires an affirmation related to the firm's statutory obligations to cooperate with the Board. Annual reports are due June 30 of each year and are publicly available on the PCAOB's website.

Firms are also required to file special reports within 30 days of such events as withdrawal of an audit report when an issuer fails to comply with SEC reporting requirements; a change in the number of issuer audit clients above or below 100; and the commencement or conclusion of criminal proceedings or government-initiated civil proceedings against a firm, partner, shareholder, principal and others.



In 2010, PCAOB staff provided answers to frequently asked questions about the annual and special reporting requirements and the process for a firm's succession to the registration of another firm. PCAOB staff also updated answers to frequently asked questions about registration of auditors of SEC-registered brokers and dealers and issues relating to non-U.S. accounting firms.

In 2010, the Board re-evaluated its approach to new registration applications from firms in non-U.S. jurisdictions that restrict or prohibit PCAOB inspections and announced new requirements for applicants from those jurisdictions.





## Number of Registered Public Accounting Firms by Jurisdiction

(AS OF DEC. 31, 2010)

JURISDICTION	NUMBER OF REGISTERED FIRMS
United States	1,503
China*	111
United Kingdom**	62
India	59
Canada	53
Australia	42
Germany	37
France	26
Singapore	22
Brazil, Israel, Russian Federation, Turkey	18 each
Italy, Mexico	17 each
Argentina, Belgium, Chile, Netherlands, Spain	16 each
Japan	15
Ireland, New Zealand	14 each
Republic of Korea, South Africa, Taiwan	12 each
Malaysia	11
Colombia, Indonesia, Peru	9 each
Sweden, Switzerland	8 each
Philippines, Poland, Thailand, Venezuela	7 each
Austria, Czech Republic, Greece, Hungary, Pakistan	6 each
Bermuda, Costa Rica, Cayman Islands, Denmark, Finland, Norway, Portugal, Romania, Ukraine, United Arab Emirates	5 each
Egypt, Luxembourg, Paraguay	4 each
Bolivia, Kazakhstan, Panama, Uruguay	3 each
Bahamas, Bahrain, Dominican Republic, El Salvador, Iceland, Vietnam	2 each
Armenia, Barbados, Belize, Croatia, Cyprus, Ecuador, Estonia, Ghana, Haiti, Jamaica, Lebanon, Malta, Mauritius, Nicaragua, Nigeria, Papua New Guinea, Slovakia, Tanzania, Tunisia	1 each
<b>TOTAL</b>	<b>2,397</b>

\* The number of registered firms in China includes firms located in Hong Kong.

\*\* The number of registered firms in the United Kingdom includes firms located in Jersey, the Isle of Man and the British Virgin Islands.

# Inspections

The PCAOB inspects registered firms that regularly issue audit reports for public companies traded in U.S. markets. Registered firms that issue audit reports for more than 100 issuers are required to be inspected on an annual basis. In 2010, the PCAOB inspected nine such firms. As part of these inspections, PCAOB inspectors examined portions of more than 350 audits performed by these firms.

## Firms with More than 100 Public Company Audit Clients

INSPECTED BY THE PCAOB IN 2010

BDO USA, LLP  
 Crowe Horwath LLP  
 Deloitte & Touche LLP  
 Ernst & Young LLP  
 Grant Thornton LLP  
 KPMG LLP  
 MaloneBailey, LLP  
 McGladrey & Pullen, LLP  
 PricewaterhouseCoopers LLP

Registered firms that issue audit reports for 100 or fewer issuers are, in general, inspected at least once every three years. The PCAOB also inspects registered firms that play a substantial role in the audits of issuers. The PCAOB inspected 245 firms in those categories in 2010, including 64 non-U.S. firms located in 20 jurisdictions. In the course of those inspections, PCAOB staff examined portions of more than 600 audits.

On Dec. 14, 2010, the Board proposed a temporary rule to establish an interim inspection program for the audits of SEC-registered brokers and dealers by registered public accounting firms, as authorized by the Dodd-Frank Act.

Many firms registered with the Board perform no audit work for issuers, brokers or dealers, and the Board does not inspect those firms.

For the firms under the Board's inspection authority, the PCAOB assesses the compliance by each firm with applicable laws, rules and professional standards during the period covered by an inspection. As part of an inspection, PCAOB inspectors evaluate the design and effectiveness of a firm's quality control system as well as the quality of the firm's work in particular audits selected for inspection.

The selection of issuer audits for review is influenced by an evaluation of the risk that issuers' financial statements could be materially misstated. The selection can be based on characteristics of the particular issuer or its industry; the audit issues likely to be encountered; considerations about the firm, practice office or individual partner; prior inspection results; and other factors. Only selected portions of an audit are inspected.

The Board prepares a report on each inspection conducted; in 2010, the Board issued 220 reports. A portion of each report is made public when issued. The portion of a report that discusses potential weaknesses or deficiencies in the firm's system of quality control is nonpublic. Any quality control criticisms remain nonpublic if the firm addresses them to the Board's satisfaction within 12 months after the report was issued. If a firm fails to satisfactorily address any of the quality control criticisms within 12 months, the portion of the report discussing those particular criticisms is made public.

In addition, the Board may publish summaries, compilations or general reports concerning the results of its various inspections, provided that no such report may identify the firm or firms that received quality control criticisms. The Board issued one summary report in 2010.

## Report on Observations of PCAOB Inspectors Related to Audit Risk Areas Affected by the Economic Crisis

On Sept. 29, 2010, the Board issued a report summarizing audit risks and challenges that were identified through PCAOB inspections as a result of the disruption in credit and financial markets and the broader economic downturn.

The report identified instances in which auditors sometimes failed to comply with PCAOB auditing standards in connection with audit areas that were significantly affected by the economic crisis, such as fair value measurements, impairment of goodwill, indefinite-lived intangible assets, other long-lived assets, allowance for loan losses, off-balance sheet structures, revenue recognition, inventory, and income taxes.

The Board's inspection staff noted that accounting firms had made efforts to address the risks associated with the economic crisis. Nonetheless, the deficiencies identified by inspectors in their reviews of issuer audits suggested that firms should continue to focus on improving their quality control systems. For its part, the Board will focus on whether firms' actions have reduced or eliminated subsequent occurrences of the kinds of deficiencies described in the report.



## Audit Reports per Registered Firm

AS OF DEC. 31, 2010 (USED FOR PLANNING 2011 INSPECTIONS)

	U.S.	Non-U.S.	Total
Firms that issued no issuer audit reports	1,017	697	1,714
Firms that issued audit reports for 1-5 issuers	286	131	417
Firms that issued audit reports for 6-10 issuers	68	30	98
Firms that issued audit reports for 11-25 issuers	66	26	92
Firms that issued audit reports for 26-50 issuers	42	6	48
Firms that issued audit reports for 51-100 issuers	14	4	18
Firms that issued audit reports for >100 issuers	10	0	10
<b>Totals</b>	<b>1,503</b>	<b>894</b>	<b>2,397</b>



# Auditors of Brokers and Dealers

The Dodd-Frank Act vested the PCAOB with new authority to oversee the auditors of brokers and dealers registered with the Securities and Exchange Commission.

Before 2010, the Securities Exchange Act required that the balance sheets and income statements filed with the SEC by registered brokers or dealers be certified by public accounting firms registered with the PCAOB, but the PCAOB had no oversight authority with respect to those audits.

In 2010, the PCAOB took steps to implement the provisions of the Dodd-Frank Act that gave the Board standard-setting, inspection and disciplinary authority over broker-dealer audits. Until the SEC provides otherwise, the SEC requires audits of brokers and dealers to be carried out under Generally Accepted Auditing Standards issued by the AICPA.

## **Interim Inspection Program for Broker-Dealer Audits**

The Dodd-Frank Act gives the Board flexibility in establishing the scope of broker-dealer audits encompassed by the inspection program, as well as in establishing elements such as the frequency of inspections. The Board intends to examine the relevant issues carefully in order to structure a permanent program that will serve the public interest and protect investors without imposing unnecessary regulatory burdens.

On Dec. 14, 2010, the Board proposed a temporary rule to establish an interim inspection program for audits of brokers and dealers. The proposed temporary rule would allow the Board to begin the work of identifying, and addressing with registered firms, significant issues in audits of brokers and dealers. The deadline for comments on the proposed temporary rule was Feb. 15, 2011.

## **Support Fees from Brokers and Dealers**

Section 109 of the Sarbanes-Oxley Act, as originally enacted, provided that funds to cover the PCAOB's annual budget, less registration and annual fees paid by registered public accounting firms, would be collected from issuers based on each issuer's relative average monthly equity market capitalization. As amended by the Dodd-Frank Act, Section 109 now requires that the Board allocate respective portions of the total accounting support fee among issuers and SEC-registered brokers and dealers and allow for differentiation among classes of brokers and dealers.

On Dec. 14, 2010, the Board proposed funding rules for the allocation of the accounting support fee among SEC-registered brokers and dealers in 2011, as provided by the Dodd-Frank Act. The proposed rules would exclude thousands of smaller brokers and dealers from being assessed a share of the fee. The deadline for comments on the proposed rules was Feb. 15, 2011.

## **Office of Outreach and Small Business Liaison**

Many of the accounting firms that audit brokers and dealers are, like their audit clients, small businesses. In connection with its new authority over those firms, and as part of its longstanding effort to maintain open lines of communication with the small business community, the Board in December 2010 established an Office of Outreach and Small Business Liaison.

This new office serves as a point of contact and communication between the Board and any PCAOB-registered public accounting firm, or any other person, affected by the Board's regulatory activities, including, in particular, those in the small business community.

## Office of Research and Analysis

The PCAOB devotes considerable resources to collecting, analyzing and providing internal business intelligence reports and risk assessments using data from public sources, vendors, registered firms and the inspection process.

Through its Office of Research and Analysis, the PCAOB uses an array of tools to monitor financial reporting and auditing risks. These tools incorporate nonpublic data collected in the inspection process and publicly available data relating to public companies' financial reporting, price and volatility information from debt and equity markets, as well as corporate governance data in order to identify those firms, offices, partners, engagements and audit issues that present the greatest audit risks. The Office also monitors news feeds and maintains data-mining applications to identify companies that may have materially misstated their financial statements.

In 2010, the PCAOB continued to enhance its use of data-driven risk assessment to select audits for inspection. The Office conducted in-depth research on numerous topics, including companies from the China region that have accessed U.S. capital markets by means of reverse mergers. As a result of its research, the Office increased and refined its referrals of potential financial reporting problems as possible focus areas in inspections.

The PCAOB named an academic fellow in June 2010, who was assigned to the Office of Research and Analysis to provide analytical support and expertise to the Office and other PCAOB staff.



## International Oversight

Public companies, whether located in the U.S. or abroad, access U.S. capital markets by complying with certain U.S. legal requirements, including the requirement to periodically file audited financial statements with the SEC.

Under the Sarbanes-Oxley Act, the auditor of those financial statements—whether a U.S. auditor or a non-U.S. auditor—must be registered with the PCAOB, and the PCAOB must regularly inspect the firm to assess its compliance with U.S. laws, rules and professional standards in connection with those audits.

As of Dec. 31, 2010, non-U.S. accounting firms registered with the PCAOB totaled 894, representing 86 jurisdictions.

During 2010, after coordinating with the relevant authorities, the PCAOB inspected 64 non-U.S. firms in 20 jurisdictions, including those where some of the largest public companies trading in U.S. capital markets are located or operate. Several of those inspections were performed jointly with the local auditor oversight authorities.

However, due to asserted restrictions under local law or objections based on national sovereignty, the PCAOB was unable to conduct inspections of registered firms in the European Union, China, Hong Kong and Switzerland that were otherwise due for inspection. More than 400 companies traded in U.S. markets are audited by registered firms in those jurisdictions. In addition, many U.S. audit firms use the work of global affiliates or other auditors in these jurisdictions.

### Inspections Outside the U.S.

One objection to PCAOB inspections often cited by non-U.S. regulators was the PCAOB's lack of authority under the Sarbanes-Oxley Act to share confidential information with its non-U.S. counterparts. That changed with the enactment of the Dodd-Frank Act on July 21, 2010, which granted the PCAOB the authority to share such information with foreign auditor oversight authorities under certain circumstances.

After enactment of the Dodd-Frank Act, the European Commission, with the approval of the European Parliament,

issued a determination permitting individual EU member state audit regulators to enter into bilateral inspection arrangements with the Board for a period of up to three years, subject to certain conditions. After the European Commission's decision, negotiations reopened with EU auditor oversight authorities in 2010. As a result, the PCAOB reached an agreement with the U.K. regulator, announced in January 2011. Separate negotiations in 2010 led to an agreement with Swiss oversight authorities, announced in April 2011. Discussions with other European regulators and the Chinese authorities are continuing.

### Investor Safeguards

In 2010, the PCAOB took note of the increasing number of companies with substantially all of their operations in another country but whose shares trade in U.S. markets and whose financial statements are audited by U.S. firms that, in turn, rely on other firms. In response, the Board issued a Staff Audit Practice Alert, reminding registered firms of their obligations when using the work of other firms or using assistants engaged from outside the firm, including those based outside the U.S. The alert was prompted, in part, by the increasing number of companies based in China and Hong Kong accessing U.S. markets via reverse mergers and other means. The PCAOB was barred from conducting inspections in China in 2010, which affected the inspections of audits of some Hong Kong-based companies with operations in China.

### Transparency

To provide more information for investors, the Board made public on its website:

- A list of the 71 registered non-U.S. firms that had not yet been inspected by the PCAOB, even though more than four years had passed since the end of the calendar year in which the firm first issued an audit report while registered with the Board.
- A list of more than 400 U.S.-traded companies whose financial statements were audited by registered firms in jurisdictions where the PCAOB was denied access to conduct inspections. The issuers on the list had filed





financial statements with the SEC in 2009 or 2010 (through mid-April). The financial statements were audited by firms in China, Hong Kong, Switzerland and certain EU member countries.

- An updated list of the 35 jurisdictions in which the Board has conducted inspections of registered non-U.S. firms since non-U.S. inspections began in 2005.
- A list of the 28 non-U.S. jurisdictions where the PCAOB planned to conduct inspections in 2010.

### **Registration of Certain Non-U.S. Firms**

In light of the continuing inability of the Board to inspect PCAOB-registered firms in some jurisdictions, the Board re-evaluated its approach to new registration applications from firms in those jurisdictions. The Board determined that its consideration of new applications from firms in those jurisdictions would no longer be premised on an expectation that obstacles to inspections would be resolved without undue delay.

On Oct. 7, 2010, the Board issued a release announcing that the Board will ask individual applicants from certain jurisdictions to state the firm's understanding of whether a PCAOB inspection of the firm would be allowed by local law or local authorities, and, if the response is that the inspection would be allowed, to supply written confirmation from the appropriate local regulatory authority.

If an applicant firm is unable to represent that the PCAOB will be able to inspect it, and to provide written confirmation from its regulator to that effect, the applicant may either keep its application pending until the obstacles to inspection are eliminated or ask the Board to act on its application despite the obstacles. If the applicant asks the Board to act on the application while inspection obstacles remain, the Board will issue a notice proposing to disapprove the registration application.

If the firm chooses to do so, it may have a hearing on the proposed disapproval. At such a hearing, the issue would be whether approval of the application would be consistent with the Board's responsibilities in light of the obstacles to inspection.

Under the Board's rules, firms that decline to request a hearing will receive notice that their applications for registration are disapproved.

### **Outreach**

In November 2010, the PCAOB convened its fourth International Auditor Regulatory Institute, drawing 75 representatives of auditor oversight bodies and government agencies from 42 countries.

The institutes were established in 2007 to provide a forum for regulators from around the world to share experiences and discuss approaches to auditor oversight and improvements to audit quality.

The 2010 institute included seminars on the structure of PCAOB auditor oversight programs; considerations relevant to international inspections; and current topics in enforcement and standard setting. The institute also included a panel discussion with representatives of several of the PCAOB's international counterparts based in Canada, Japan, the Netherlands, Norway, and the U.K.

The PCAOB also continued to participate as a member in meetings and working groups of the International Forum of Independent Audit Regulators (IFIAR). IFIAR's objectives include sharing knowledge of the audit market environment and practical experience of independent audit regulatory activity; promoting collaboration in regulatory activity; and providing a point of contact for other international organizations that have an interest in audit quality.

In addition, the PCAOB continued its efforts in 2010 to monitor the activities of various international professional bodies that develop professional standards for auditors. To this end, the PCAOB served as an observer to the International Auditing and Assurance Standards Board of the International Federation of Accountants (IFAC), as well as IFAC's International Ethics Standards Board for Accountants. The PCAOB also served as an observer to the two consultative advisory groups of those boards, as well as the consultative advisory group to IFAC's International Accounting Education Standards Board.

# Standards

The Sarbanes-Oxley Act gave the PCAOB the responsibility to set auditing and related professional practice standards that strengthen the reliability of public company audits for investors and others who have a stake in the accuracy of companies' financial reporting.

The standards—covering auditing, attestation, quality control, ethics and independence—enable the PCAOB to measure the conduct of firms and associated persons in their audits of public companies. The standards are applied in inspections and, when necessary, in disciplinary proceedings.

The PCAOB examines its standards in the light of emerging financial trends, changes in accounting standards, market conditions and other events that can affect the quality of audits. The Board works closely with the SEC and the Financial Accounting Standards Board on the development of standards and actively seeks review and discussion of its standards and their appropriateness from investors, auditors and public companies through its Standing Advisory Group, Investor Advisory Group and other outreach.

To remind auditors of existing responsibilities, the PCAOB's Office of the Chief Auditor issues Staff Audit Practice Alerts to highlight new, emerging or otherwise noteworthy circumstances that may affect how auditors conduct audits under existing PCAOB standards and relevant laws. The PCAOB staff also issues question-and-answer documents, describing the staff's opinions on issues related to the implementation of the standards of the PCAOB. Neither the alerts nor the staff questions and answers are rules of the Board.

PCAOB standards are rules of the Board, and the Board uses a notice-and-comment process similar to the process used by federal agencies and other standard setters, under which the Board proposes standards for public comment before adopting new or amended standards in a public meeting. All Board standards must be approved by the SEC before they can become effective.



In 2010, the Board adopted a suite of eight standards related to the assessment of and response to risk in an audit. These standards address many fundamental aspects of the audit, from the initial planning stages through the evaluation of audit results.

Lingering effects of the financial crisis in 2010, as well as a sharp uptick in non-U.S. companies seeking capital in U.S. markets, prompted the PCAOB to alert auditors to existing standards relating to public companies' use of unusual transactions; disclosure of potential liabilities related to mortgages and foreclosures; and their obligations when using the work of other firms or assistants engaged from outside the firm, including firms and assistants based outside the U.S. in jurisdictions where the PCAOB may be barred from inspecting firms.

The Board also proposed standards for confirmation procedures by auditors and standards for communications with audit committees. The proposals are part of an ambitious standard-setting agenda for the Board in 2011.

## Risk Assessment Standards

In August 2010, the Board adopted eight auditing standards and related amendments that benefit investors by establishing requirements to enhance the effectiveness of the auditor's assessment of and response to the risks of material misstatement in an audit. The standards were approved by the SEC on Dec. 23, 2010.

The standards address fundamental aspects of the audit, including audit planning and supervision; the auditor's assessment of and response to the risks of material misstatement in the financial statements; and the auditor's evaluation of audit results and audit evidence.

The standards require the auditor to consider the risk of material misstatement due to fraud throughout the audit. They also require auditors to perform procedures to evaluate the completeness and fairness of financial statement disclosures. Such disclosures are critical to providing investors an understanding of matters that became particularly important during the financial crisis, such as valuation of complex financial instruments.

The new standards replaced interim auditing standards that had been developed in the 1980s. Before their adoption, the PCAOB standards were vetted in two rounds of public comment and several public meetings with the Board's Standing Advisory Group.

## Staff Audit Practice Alerts

The PCAOB responded in 2010 to newsworthy events that exposed possible threats to the reliability of some companies' financial statements and heightened the need for vigilance on the part of auditors.

### *Unusual Transactions*

On April 7, 2010, the PCAOB issued a Staff Audit Practice Alert to remind auditors of public companies about their responsibilities to assess and respond to the risk of material misstatement of the financial statements due to error or fraud posed by significant

unusual transactions, such as those identified after certain business failures during the financial crisis.

Staff Audit Practice Alert No. 5, *Auditor Considerations Regarding Significant Unusual Transactions*, focused auditors on the evaluation of significant transactions that are outside the normal course of business for a company or otherwise appear to be unusual given the auditor's understanding of the company and its environment. Such transactions may be mechanisms to achieve a specific, desired accounting result, as opposed to serving a valid business purpose.

The alert compiled relevant requirements from existing PCAOB auditing standards regarding significant unusual transactions and was issued to assist auditors in reviews of interim financial information and audits of financial statements.

### *Using the Work of Other Auditors*

On July 12, 2010, the Board published Staff Audit Practice Alert No. 6, *Auditor Considerations Regarding Using the Work of Other Auditors and Engaging Assistants from Outside the Firm*, reminding registered firms of their obligations when using the work of other firms or using assistants engaged from outside the firm, including firms and assistants based outside the U.S. The alert was prompted, in part, by an increase in the number of issuers whose financial statements are audited by U.S. firms while having substantially all of their operations in another country. Those issuers include companies based in China and Hong Kong that have accessed U.S. markets via reverse mergers and other means. The PCAOB continued to be barred from conducting inspections in China in 2010, which affected the inspections of audits of some Hong Kong-based companies with operations in China.

### *Contingencies Arising from Mortgage and Other Loan Activities*

Ongoing uncertainty in the housing market and widespread foreclosures in 2010 raised questions about the effect of uncollectable loans on banks and issuers of mortgage-backed securities.



## Standards

On Dec. 20, 2010, the Board published Staff Audit Practice Alert No. 7, *Auditor Considerations of Litigation and Other Contingencies Arising from Mortgage and Other Loan Activities*, to remind auditors of public companies about their responsibilities when auditing loss contingencies, disclosures and related items.

The alert followed reports that banks may have misrepresented the quality of mortgages sold and could be required to repurchase the affected mortgages. Other reports suggested that companies servicing \$6.4 trillion in mortgages may have bypassed legally required steps to foreclose on homes.

The practice alert advised auditors that these mortgage- and foreclosure-related risks could have implications for audits of financial statements or of internal control over financial reporting. These implications might include accounting for litigation or other loss contingencies and the related disclosures.

### Proposed Standards

#### *Audit Confirmations*

On July 13, 2010, the Board issued for public comment a proposed auditing standard, Confirmation, that would update and expand the requirements related to the auditor's use of confirmations—the direct communications between an auditor and a third party about a particular item affecting a company's financial statements.

The proposed standard would expand the scope of the confirmation requirement, calling for the confirmation of a wider range of accounts receivable than were specified in PCAOB standards at the time. The proposal includes a new requirement to confirm cash held with financial institutions—a response to frauds based on fictitious bank accounts.

The proposed standard also addresses changes in confirmation practice, recognizing the prevalence of electronic communications, electronic recordkeeping and the Internet as well as the increasing frequency with which respondents include disclaimers and restrictive language in their responses.

The proposed standard would also more explicitly incorporate consideration of the risk of error or fraud into the selection,

design and planning of confirmation procedures. The deadline for comments on the proposal was Sept. 13, 2010.

#### *Communications with Audit Committees*

On March 29, 2010, the Board voted to propose for comment an auditing standard on communications with audit committees and a series of related amendments to the PCAOB's interim standards.

The proposed standard includes a requirement for the auditor to establish a mutual understanding of the terms of the audit engagement with the audit committee and to document that understanding in an engagement letter. The proposal also includes requirements relating to

- Communication of an overview of the audit strategy, including a discussion of significant risks; the use of the internal audit function; and the roles, responsibilities and location of firms participating in the audit;
- Communication regarding critical accounting policies, practices and estimates;
- Communication regarding the auditor's evaluation of a company's ability to continue as a going concern; and
- Evaluation by the auditor of the adequacy of the two-way communications between the auditor and audit committee to better achieve the objectives of the audit.

Interest in the proposed standard prompted the Board to reopen the comment period and hold a public roundtable on Sept. 21, 2010. Participants included representatives of audit committees, investors, auditors, issuers and others.

Among the issues discussed were communications beneficial to audit committees; accounting policies, practices and estimates; effective two-way communication between the auditor and audit committee; balance between written and oral communications; audit committee responsibilities in the engagement letter; management communications; and uncorrected misstatements. The deadline for comments on the proposal was Oct. 21, 2010.



## Future Standard Setting

The Board bases its standard-setting agenda on information from a variety of sources, including issues identified during PCAOB inspections of registered accounting firms; changes in accounting standards; and discussions with its Standing Advisory Group, Investor Advisory Group and others.

Several potential standards under consideration for 2011 will continue the Board's efforts to address lessons learned from the financial crisis.

The Board is considering possible improvements to the auditor's reporting model based on extensive consultation with investors, other users of financial statements, auditors, public companies and members of the academic community. In 2010, PCAOB staff began gathering information on potential changes to the content and format of audit reports, as well as potential challenges that changes would raise.

The Board is also considering possible revisions to the standards on auditors' use of specialists; fair value measurements and financial instruments; and quality control standards for accounting firms.

The Board continues to evaluate responses to a recommendation for a "standard-setting initiative to consider mandating the engagement partner's signature on the auditor's report," made by the Treasury Department's Advisory Committee on the Auditing Profession. The Board issued a concept release on a possible standard on July 28, 2009, and received public comments.

In another release, *Application of the "Failure to Supervise" Provision of the Sarbanes-Oxley Act of 2002 and Solicitation of Comment*, the PCAOB discussed the provision of the Act that authorizes the PCAOB to impose sanctions on registered public accounting

firms and their supervisory personnel for failing to reasonably supervise associated persons. The release, issued Aug. 5, 2010, sought comments on concepts relating to possible rulemaking or standard setting that, without imposing any new supervisory responsibilities, would require firms to make and document clear assignments of the supervisory responsibilities that are already required to be part of any audit practice. The deadline for comments on the release was Nov. 3, 2010.

## Standing Advisory Group

Consistent with Section 103 of the Sarbanes-Oxley Act, the Board convened its Standing Advisory Group to advise the PCAOB on the development of auditing and related professional practice standards. SAG members include investors, auditors and representatives of public companies and the academic community.

The SAG is an important resource for the Board in identifying emerging standard-setting issues and hearing views on standard-setting initiatives from a broad range of perspectives. At the close of 2010, the SAG had 30 members with expertise in accounting, auditing, corporate finance, corporate governance and investing.

Six organizations have observer status at the meetings of the SAG: the Securities and Exchange Commission, the Financial Accounting Standards Board, the Government Accountability Office, the Department of Labor, the Auditing Standards Board of the American Institute of Certified Public Accountants, and the International Federation of Accountants' International Auditing and Assurance Standards Board.

The SAG met three times in 2010. Briefing papers, slide presentations and recordings of the discussions are available on the PCAOB's website.

## Standards



### *Part of Audit Performed by Other Independent Auditors; Auditor's Reporting Model*

On April 7-8, 2010, SAG members discussed strengthening certain requirements relating to using the work and reports of other independent auditors. Specifically, SAG members discussed the decision to serve as principal auditor and assuming responsibility for the other auditor's work.

In addition, SAG members discussed a recommendation by the Treasury Department's Advisory Committee on the Auditing Profession relating to the auditor's reporting model. Panelists presented information to the SAG relating to the history and evolution of the U.S. standard auditor's report and the ACAP recommendation.

### *Broker-dealer Audits; Changes in Accounting Standards; Subsequent Events*

At the time of the July 15, 2010, SAG meeting, Congress was considering proposed legislation that would give the Board full oversight authority, including standard-setting authority, over auditors of SEC-registered brokers and dealers. In light of this anticipated new authority, SAG members discussed certain aspects of broker-dealer audits.

In addition, a panel discussed joint accounting projects of the FASB and International Accounting Standards Board and the potential impact on auditors. Staff from the Office of the Chief Auditor also sought feedback from SAG members on whether the Board should revise the auditing standard related to events or transactions that occur "subsequent to the balance-sheet date, but prior to the issuance of the financial statements, that have a material effect on the financial statements and therefore require adjustment or disclosure in the statements."

### *Systems of Quality Control; Changes in Accounting Standards*

In their Oct. 13-14, 2010, meeting, SAG members heard updates from PCAOB staff on several initiatives, including the PCAOB's Sept. 29, 2010, *Report on Observations of PCAOB Inspectors Related to Audit Risk Areas Affected by the Economic Crisis*.

In addition, SAG members discussed topics related to the design and implementation of systems of quality control in audit firms, including potential challenges such as changes in financial reporting frameworks and cross-border auditing.

SAG members also followed up the July meeting with discussions of changes in accounting standards and related auditing implications. Topics included the increased use of fair values, estimates and judgments; increased emphasis on disclosure objectives and related disclosure principles; and changes in accounting disclosure requirements for contingencies.

The Office of the Chief Auditor provided updates about the PCAOB's standard-setting agenda and other developments affecting the work of the PCAOB. The Acting Chairman provided an update on the PCAOB response to the recommendations made by the Treasury Department's Advisory Committee on the Auditing Profession.

## Outreach

Given the nature of the PCAOB's work in the public interest, the Board makes a concerted effort to inform, educate and obtain input from a broad cross section of the public, including investors, auditors, the academic community and other interested parties.

The Board believes that public awareness and interaction with the PCAOB enhances the effectiveness of its oversight of auditors by providing the PCAOB with insight into audit risks and environmental factors that may affect such risks. The interaction also enables the PCAOB to provide auditor guidance and other educational materials, which may contribute to improving audit quality.

### Office of Outreach and Small Business Liaison

In December 2010, the Board announced the establishment of a new Office of Outreach and Small Business Liaison to enhance its efforts to provide and obtain information about its work.

The Office is responsible for planning and conducting forums, including both the Board's existing Forums on Auditing in the Small Business Environment and new forums directed to the smaller communities of SEC-registered brokers and dealers and their auditors.

The Office also seeks input from the small business community, including public companies, brokers and others, on issues related to the Board's work. The Office serves as a point of contact for questions about PCAOB activities. It also assists in identifying areas where information related to the Board's work may not be well understood and suggesting action to address these areas.

### Forum on Auditing in the Small Business Environment

Each year, the Board hosts a series of Forums on Auditing in the Small Business Environment. These day-long presentations are designed to allow auditors in smaller firms to learn about the PCAOB's work, to provide feedback and to ask questions about PCAOB activities, including PCAOB inspections procedures and new auditing standards and guidance. The format promotes an open dialogue among PCAOB representatives and forum participants.

In 2010, 666 people attended seven forums, held in Charlotte, N.C.; San Francisco; New York City; Jersey City, N.J.; Irvine, Calif.; Dallas; and Miami.

The 2010 forums provided attendees with updates on PCAOB standard-setting activities, including a discussion of PCAOB Auditing Standard No. 7, *Engagement Quality Review*; risk assessment standards; proposed standards related to confirmation and communications with audit committees; and a concept release on supervisory responsibilities.

PCAOB staff also addressed auditor considerations regarding significant unusual transactions, using the work of other auditors and engaging assistants from outside the firm, as well as economic issues and trends affecting audits. The agenda included several case studies on auditing in the small business environment.

### Investor Advisory Group

The PCAOB's Investor Advisory Group held its inaugural meeting May 4, 2010. The group was created to provide a forum for the Board to obtain the views of, and advice from, the investor community on matters affecting investors and the work of the PCAOB. Members of the Investor Advisory Group represent a broad spectrum of the investment community as well as individuals who have a demonstrated history of commitment to investor protection.

At its first meeting, the 19-member Investor Advisory Group provided views and advice to the Board through panel discussions on "Lessons Learned from the Financial Crisis and the Establishment of a Fraud Center;" "Foreign Inspections;" "Greater Transparency and Governance of Audit Firms;" "Greater Transparency of the Audit Process;" and "Auditor Expertise and Responsibilities."

During 2010, the group's advice and insight were considered by the Board as it discussed possible revisions to the auditor's report; lessons learned from the financial crisis; efforts to inspect non-U.S. accounting firms; transparency about the clients of firms in jurisdictions where PCAOB inspections are blocked; and critical issues of interest to auditors and corporate directors.



## Outreach

### Legislative Initiatives

The PCAOB monitored and provided information on several legislative initiatives in 2010, most notably the initiatives that led to the Dodd-Frank Act. The law, as enacted, provided new authority for PCAOB oversight of the auditors of SEC-registered brokers and dealers, and it empowered the Board to share information with non-U.S. audit regulators, clearing an impediment to inspections of some non-U.S. firms.

On May 21, 2010, Acting Chairman Daniel L. Goelzer testified before the Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises of the House Financial Services Committee concerning "Accounting and Auditing Standards: Pending Proposals and Emerging Issues."

In a letter to members of Congress on Aug. 24, 2010, Acting Chairman Goelzer requested an amendment to the Sarbanes-Oxley Act that would make Board disciplinary proceedings public when the Board decides that the evidence gathered in an investigation warrants charging a firm or individuals with violations. The letter, delivered to the leaders of the House Financial Services Committee and the Senate Committee on Banking, Housing and Urban Affairs, noted that the "nonpublic nature of Board disciplinary proceedings has serious adverse consequences for the investing public, audit committees, the auditing profession, the Board and other interested parties, such as Congress."

### Audit Risk Working Group

The PCAOB, through senior staff of its Office of Research and Analysis and Office of the Chief Auditor, continued its periodic Audit Risk Working Group meetings with the lead technical partners of the largest registered firms and rotating representation of smaller registered firms. The meetings allow participants to discuss events and trends that could affect audit risk and the firms' risk assessment and mitigation methodologies.

### Academic Conference

In April 2010, the PCAOB hosted its sixth Academic Conference, planned jointly by the staff of the PCAOB and members of the Auditing Section of the American Accounting Association.

The conference was attended by 56 members of the academic community, as well as PCAOB Board members and staff and representatives of the SEC, the FASB and the GAO.

The conference is intended to facilitate the exchange of ideas among PCAOB representatives and members of the academic community regarding matters of mutual interest; stimulate academic research relevant to the mission of the PCAOB; and explore areas of competence demanded of future auditors of public companies, as well as possible methods for improving the extent to which education prepares students to meet the challenges related to achieving the mission of the PCAOB.

At the 2010 conference, participants presented and discussed two research papers: *Improving Fraud Detection: Evaluating Auditors' Reactions to Abnormal Inconsistencies Between Financial and Nonfinancial Measures* and *Fraudulent Financial Reporting: 1998-2007. An Analysis of U.S. Public Companies*.

PCAOB staff presented, for discussion, a briefing paper on the recommendation relating to the auditor's reporting model made by the Treasury Department's Advisory Committee on the Auditing Profession.

### Participation in Other Forums

Board members and staff participated in numerous forums in 2010 to provide information about the PCAOB's work on investor protection and auditor oversight.

Forum sponsors included the Council of Institutional Investors, the AICPA, the University of Southern California's Leventhal School of Accounting, the National Association of State Boards of Accountancy, the University of Denver School of Accountancy, the Federal Deposit Insurance Corp. and the New York State Society of CPAs. Audiences for these events included investors, auditors, issuers, other regulators, members of the academic community and students.

# Enforcement



The Sarbanes-Oxley Act authorizes the PCAOB to investigate auditor conduct that may violate auditing and related professional practice standards, the Act and PCAOB rules, as well as other laws and rules applicable to the preparation and issuance of audit reports for public company audit clients and related obligations and liabilities of accountants.

The Sarbanes-Oxley Act also empowers the Board to impose appropriate disciplinary sanctions on registered firms and associated persons who violate those laws, rules or standards. Enforcement sanctions are designed to deter auditor misconduct and protect investors. Possible sanctions include civil money penalties, the revocation of a firm's PCAOB registration, the appointment of an independent monitor, the barring of an individual from association with a registered accounting firm and the requirement to obtain additional professional training.

PCAOB investigations are, by law, confidential and nonpublic. In 2010, the Board initiated 15 formal investigations. In addition, the PCAOB conducted informal inquiries and continued investigations that began in prior years. At the end of

December 2010, the PCAOB was engaged in 23 formal investigations. These investigations encompass issuer audits of varying size and complexity. PCAOB enforcement staff closely coordinates its investigations and inquiries with the enforcement staff of the Securities and Exchange Commission.

The Sarbanes-Oxley Act mandates that PCAOB disciplinary proceedings are nonpublic, unlike similar auditor proceedings brought by the SEC. The Board discussed the implications of that requirement in an open meeting Aug. 5, 2010. In a letter to members of Congress on Aug. 24, 2010, Acting Chairman Daniel L. Goelzer requested an amendment to the Sarbanes-Oxley Act that would make Board disciplinary proceedings public when the Board decides that the evidence gathered in an investigation warrants charging a firm or individuals with violations.

## Disciplinary Proceedings and Actions

The Board issued seven settled disciplinary orders in 2010, imposing sanctions ranging from censures to bars on association with registered accounting firms, as well as monetary penalties. Other disciplinary proceedings against firms and individuals were approved by the Board in 2010. Those proceedings are being contested and are nonpublic as required by the Sarbanes-Oxley Act. As with the Board's investigations, these disciplinary proceedings relate to issuer audits of varying size and complexity.

### *Violations of PCAOB Rules and Auditing Standards in Audits of Issuers*

Two settled proceedings involved a partner and manager in the Salt Lake City office of Grant Thornton, LLP and their work in auditing the 2004 financial statements of Imergent Inc. After initiating nonpublic proceedings, the Board accepted offers of settlement from engagement partner Ray Westergard and manager Jennifer Nakao. In the settled proceeding, the Board found that Westergard and Nakao violated PCAOB rules and auditing standards in the context of auditing Imergent's 2004 revenue, allowance for doubtful accounts and related financial statement footnote disclosures. Based on these findings, and offers of settlement made by Westergard and Nakao without admitting or denying the Board's findings, the Board barred

## Enforcement

Westergard from being an associated person of a registered public accounting firm with a right, after two years, to petition the Board for consent to associate with a registered public accounting firm. The Board suspended Nakao from being an associated person of a registered public accounting firm for a period of one year from the date of the order, Feb. 17, 2010.

In a separate proceeding announced on April 27, 2010, the Board found that Robert T. Taylor, CPA and his firm, also known as Robert T. Taylor, CPA, violated PCAOB rules and auditing standards in auditing the financial statements of an issuer client, American Fiber Green Products Inc., from 2006 to 2008. The Board found that in each audit year and in significant audit areas, Taylor and his firm failed to: plan adequately for the audit; perform audit procedures on the issuer's assets and liabilities; consider whether certain assets still existed or were impaired; and prepare and maintain sufficient audit documentation. Based on these findings and in response to offers of settlement from Taylor and his firm, made without admitting or denying the findings, the Board revoked the firm's registration and permanently barred Taylor from being an associated person of a registered public accounting firm.

In another proceeding announced on Aug. 12, 2010, the Board found that Traci Jo Anderson, CPA and her firm of the same name engaged in numerous and repeated violations of PCAOB rules and auditing standards in auditing the financial statements of three issuer clients from 2007 to 2009. In addition, Anderson and her firm failed to prepare audit documentation as required by PCAOB Auditing Standard No. 3, *Audit Documentation*. Based on these findings and in response to offers of settlement from Anderson and her firm, made without admitting or denying the findings, the Board revoked the firm's registration and permanently barred Anderson from being an associated person of a registered public accounting firm.

### *Failure to Cooperate with a PCAOB Investigation*

Two managers with the registered public accounting firm of Lovelock & Lewes, Chartered Accountants, consented in separate matters to being permanently barred from association with a registered public accounting firm after refusing to cooperate

with a Board investigation by failing to comply with a Board demand requiring their testimony in connection with a PCAOB investigation of the audits of Satyam Computer Services Ltd. Lovelock is one of five members of the PricewaterhouseCoopers International Limited network of firms that is located in India and registered with the Board. Lovelock participated in the audits of Satyam's financial statements for 2005 through 2008.

On Jan. 7, 2009, Satyam filed a Form 6-K with the SEC, in which it disclosed that its founder and then chairman had revealed that he had inflated key financial results for the issuer, including overstating a cash balance by \$1 billion, overstating profits for several years, overstating the amount of debt owed to the issuer and understating the issuer's liabilities. The Board issued an order of formal investigation regarding the audits and reviews of the financial statements of Satyam. The PCAOB Division of Enforcement and Investigations issued demands to managers Chintapatla Ravindernath and Siva Prasad Pulavarthi, requiring each to appear for testimony. After several attempts to accommodate Prasad and Ravindernath with respect to the dates and location of testimony, including a delay to allow new counsel to become familiar with the matter, Prasad and Ravindernath, through counsel, informed the Division that they would not comply with the demand for testimony. Based on these findings and in response to offers of settlement from Prasad and Ravindernath, made without admitting or denying the findings, the Board permanently barred each from being an associated person of a registered public accounting firm.

### *Altering Audit Documents Before Inspection*

In a settled proceeding, the Board found that Jacqueline A. Higgins, CPA, an Ernst & Young LLP manager, violated PCAOB rules and auditing standards in connection with improper removal, addition and backdating of audit documentation prior to a PCAOB inspection. Higgins was the manager for the audit of an issuer's Sept. 30, 2009, financial statements. Higgins was supervised by an engagement partner and a senior manager during the course of the audit. The Board found that Higgins violated PCAOB Rule 4006, *Duty to Cooperate with Inspectors* and Auditing Standard No. 3, *Audit Documentation*, by: (1) adding documents to the working papers without indicating the dates



that documents were added to the working papers, the names of the persons preparing the additional documentation, and the reason for adding the documentation months after the documentation completion date; and (2) removing a document from the working papers after the documentation completion date. Based on these findings and an offer of settlement from Higgins, made without admitting or denying the findings, the Board censured her in an order issued Dec. 3, 2010.

### Adjudicated Disciplinary Orders and Opinions

The Board published two final decisions in adjudicated matters in 2010. Under the Sarbanes-Oxley Act, any person sanctioned by the Board may seek review by the SEC in accordance with SEC rules, and any such application for review operates as a stay of the sanction. The Sarbanes-Oxley Act prohibits the Board from reporting the sanction to the public unless and until the SEC lifts the stay of the sanction. Because of the stay, the Board does not publish Board orders and opinions before the SEC review has occurred or the opportunity to seek SEC review has passed. In addition, because of the stay, the effective date of the sanctions imposed by the Board is different from the date of the Board action imposing the sanctions.

On June 4, 2009, the Board issued a final decision and order imposing sanctions against Gately & Associates, LLC and James P. Gately, CPA. A PCAOB hearing officer had previously issued a decision permanently revoking the firm's registration with the Board and permanently barring Gately from association with any registered public accounting firm for failing to cooperate in a PCAOB inspection in violation of PCAOB Rule 4006, *Duty to Cooperate with Inspectors*. Based on a de novo review of the record, the Board found that Gately and his firm failed to cooperate in a PCAOB inspection in violation of Rule 4006 and ordered that Gately be permanently barred from associating with any registered public accounting firm and that the firm's registration with the Board be permanently revoked.

Gately and the firm filed an application pursuant to Section 107(c) of the Sarbanes-Oxley Act for SEC review of disciplinary action taken by the PCAOB, which stayed the effect of the Board's sanctions and prevented the Board from publishing its findings.

On Aug. 5, 2010, the Commission held that the findings of violation and sanction imposed by the Board were sustained, and the sanctions took effect Oct. 22, 2010.

In a separate case, the Board issued a final decision and order on Oct. 19, 2010, imposing sanctions against Larry O'Donnell and his registered accounting firm, Larry O'Donnell, CPA, P.C. On review of the hearing officer's initial decision, the Board found, as the hearing officer did, that O'Donnell and his firm engaged in conduct constituting noncooperation with an investigation. The Board ordered that O'Donnell be permanently barred from associating with any registered public accounting firm and that the O'Donnell firm's registration be permanently revoked. The Board also imposed a civil monetary penalty in the amount of \$75,000 on O'Donnell.

O'Donnell and his firm did not file an application for review by the SEC, and the SEC did not order review of sanctions ordered against O'Donnell and his firm on its own motion. The sanctions became effective Dec. 14, 2010.

### Board Release Regarding Failure to Supervise

The Sarbanes-Oxley Act authorizes the PCAOB to impose sanctions on registered public accounting firms and their supervisory personnel for failing to reasonably supervise associated persons. On Aug. 5, 2010, the Board issued a release, *Application of the "Failure to Supervise" Provision of the Sarbanes-Oxley Act of 2002 and Solicitation of Comment on Rulemaking Concepts*. The release reminds registered firms and associated persons of, and highlights the scope of, the Board's authority.

The release also discusses concepts relating to possible rulemaking or standard setting that, without imposing any new supervisory responsibilities, would require firms to make and document clear assignments of the supervisory responsibilities that are already required to be part of any audit practice. The Board is considering whether such rules would serve to further the public interest and protect investors by increasing clarity about who within the firm is accountable for various responsibilities that bear on the quality of the firm's audits. The deadline for comments was Nov. 3, 2010.



# Operations

Consistent with the public-service mantle that overlays its responsibilities, the PCAOB strives to exercise careful stewardship over its resources to maximize its effectiveness in protecting the investing public.

The Sarbanes-Oxley Act of 2002 established the PCAOB as a nonprofit, non-governmental organization. As a result, the PCAOB does not receive federal appropriations for its operations. Under the provisions of the Sarbanes-Oxley Act, the PCAOB was funded in 2010 by fees collected from public companies and other issuers, less registration and annual fees paid by registered public accounting firms.

In compliance with the Sarbanes-Oxley Act, the Board adjusts its fees to account for public companies' market capitalizations and the size and audit client bases of registered accounting firms. As a result, many of the smallest companies and accounting firms pay little to no fees for the operations of the PCAOB.

In light of its accountability to the SEC and the public, the PCAOB devotes resources to maintaining and assessing the effectiveness of its internal control over financial reporting and monitors its operations through its Office of Internal Oversight and Performance Assurance.

## Budgeting

The PCAOB's budget for 2010, as approved by the Board on Nov. 30, 2009, was \$183.3 million. The SEC approved the PCAOB's 2010 budget and related accounting support fee by order dated Dec. 22, 2009.

Under the Sarbanes-Oxley Act, the PCAOB budget provides the foundation for the assessment of accounting support fees paid by public companies and other issuers. The total assessment in 2010 was \$178.1 million.



In addition, all accounting firms registered with the PCAOB as of March 31, 2010, were assessed an annual fee based on the number of issuer audit clients and personnel at each firm.

On Dec. 14, 2010, the Board proposed a funding rule for allocation of the accounting support fee among SEC-registered brokers and dealers in 2011, as provided by the Dodd-Frank Act. The proposed rule would exempt thousands of smaller brokers and dealers from the fee and revise the Board's existing funding rule in a way that would also increase the number of smaller issuers and investment companies that are exempt from the accounting support fee. The deadline for comments on the proposed rule was Feb. 15, 2011.

Each year, the PCAOB's budget-setting process is subject to SEC oversight, including review, comment and approval. On Nov. 23, 2010, the Board approved the PCAOB's 2011 budget and accounting support fee. The SEC approved the budget and accounting support fee on Dec. 22, 2010.

## Staffing

The PCAOB's specialized work in the oversight of auditors requires a highly qualified workforce of experienced accountants, attorneys, analysts and others. In 2010, the PCAOB increased its staff by 33, including 24 inspections staff members, ending the year with a total of 600 staff. More than 50 percent of PCAOB staff work in registration and inspections.

## Technology

The Board uses information technology to enhance the effectiveness of its programs, operations and initiatives. In 2010, the PCAOB continued development and support of a web-based system to receive and publish registered firms' annual and special reports. In addition, the PCAOB completed work on the redesign of its website.

The PCAOB also continued to work on implementing an inspections information system to record and analyze information obtained in inspections and on planning a redesign of the PCAOB's risk analysis database system in 2010. With regard to daily operations, the PCAOB continued to seek opportunities to streamline the PCAOB's technological infrastructure while also maintaining reliable and secure information systems.

## Financial Reporting Management and Internal Control over Financial Reporting

The PCAOB's financial reporting management—comprising the chairman, chief administrative officer, deputy chief administrative officer and director of finance—performed an assessment of the PCAOB's internal control over financial reporting and concluded that the PCAOB's internal control over financial reporting was effective as of year end 2010. The Board also engaged its independent auditor to perform an audit of the PCAOB's internal control over financial reporting, consistent with Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting that Is Integrated with An Audit of Financial Statements*.

## Office of Internal Oversight and Performance Assurance

The Office of Internal Oversight and Performance Assurance performs a role similar to that of an inspector general in a government agency. IOPA conducts performance reviews of PCAOB programs and operations, provides timely quality assurance assessments to the Board, and also may receive and review allegations of wrongdoing by PCAOB employees. IOPA conducts its performance reviews in accordance with the GAO's Government Auditing Standards (Yellow Book).

In 2010, IOPA completed reviews of the PCAOB's reporting of performance in connection with the organization's strategic plan; its response to recommendations in IOPA reviews from previous years; and inspections documentation. Summaries of the reviews were sent to the chairman of the SEC and are posted on the PCAOB's website.

### PCAOB Offices

HEADQUARTERS  
Washington, D.C.

#### REGIONAL AND SATELLITE OFFICES

Atlanta, Georgia	Houston, Texas
Boston, Massachusetts	Irvine, California
Charlotte, North Carolina	Irving, Texas
Chicago, Illinois	New York, New York
Denver, Colorado	San Mateo, California
Detroit, Michigan	Tampa, Florida

# Financial Review

This financial review, together with the 2010 audited financial statements and the accompanying notes, provides financial information and disclosures related to the PCAOB's programs and activities described in the other sections of this annual report.

The PCAOB's budget, once approved by the SEC, is funded through an accounting support fee assessed on public companies, also referred to as "issuers." The accounting support fee is equal to the PCAOB's budget, less registration and annual fees paid by public accounting firms, estimated interest income, and excess funds from the prior year's operations. In 2010, the PCAOB invoiced 9,215 issuers for a total accounting support fee of approximately \$178.1 million.<sup>1</sup>

Section 102(f) of the Sarbanes-Oxley Act requires the PCAOB to assess and collect registration application fees from applicants and annual fees from registered firms in amounts sufficient to cover the costs incurred by the PCAOB to process and review registration applications and required reports. PCAOB rules implementing certain aspects of Section 102 became effective at the end of 2009 and, among other things, required registered firms to file annual reports and pay annual fees in 2010. In 2010, the PCAOB invoiced approximately \$1.7 million in annual fees to 2,444 registered accounting firms.

The PCAOB's operating expenses in 2010 were approximately \$167.4 million, compared to approximately \$148.9 million in 2009. This 12 percent increase (approximately \$18.5 million) was primarily due to a higher number of employees and related expenses, as discussed further in this review.

## *Presentation of Financial Statements*

The PCAOB's financial statements are presented in accordance with accounting principles generally accepted in the United States of America using the standards applicable to Not-for-Profit Entities. A discussion of the statements of financial position and the accompanying statements of activities follows.

## **Statements of Financial Position**

The PCAOB reported unrestricted net assets of approximately \$95.1 million as of Dec. 31, 2010, an increase of approximately \$12.9 million compared to Dec. 31, 2009. The change in net assets was primarily due to an increase in accounting support fee revenue and the assessment of an annual fee to registered accounting firms, partially offset by operating expenses. The increase in net assets was substantially more than planned primarily due to lower than expected operating expenses mainly due to lower headcount than anticipated. Total net assets include approximately \$1.1 million in collections of civil monetary penalties that are statutorily designated for exclusive use toward a scholarship program by Section 109(c)(2) of the Act.

## *Cash and Cash Equivalents*

Cash and cash equivalents include demand deposits and overnight investment accounts with financial institutions, and short-term, highly liquid investments. The cash balance decreased from approximately \$85.9 million in 2009 to approximately \$20.6 million in 2010 primarily due to a change in investment strategy to resume investing in U.S. Treasury bills.

The PCAOB's monthly cash outflow is relatively constant during the year, yet its cash inflows are cyclical as the majority of cash is collected late in the second quarter of each year from the assessment of the accounting support fee and annual fee. The timing of the cash flows requires the PCAOB to retain a substantial cash balance sufficient to fund the PCAOB's operations for the first few months of the subsequent year.

In both 2009 and 2010, the Financial Accounting Foundation designated the PCAOB as the collection agent for invoicing and collecting the FASB accounting support fees. As a result, the balance of cash and cash equivalents also included approximately \$26,000 and \$10,000 of cash collected on behalf of the FASB as of Dec. 31, 2010, and 2009, respectively. Corresponding amounts are included in accounts payable and other liabilities in 2010 and 2009.

1. Section 982 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), signed into law on Jul. 21, 2010, amended the Sarbanes-Oxley Act to provide the PCAOB with the authority to oversee auditors of brokers and dealers registered with the SEC (SEC-registered broker-dealers) including inspections, enforcement and standard-setting authority. The PCAOB expects to bill SEC-registered broker-dealers an accounting support fee beginning in 2011.

The PCAOB maintains substantially all its cash and cash equivalents, which exceed federally insured limits, with a major financial institution.

### *Short-term Investments*

The PCAOB continued in 2010 to adapt its cash and investment strategy to maximize investment return and minimize exposure to credit risk. As a result, the Board resumed investing in U.S. Treasury bills during 2010. The Board had approximately \$80.0 million invested in U.S. Treasury bills as of Dec. 31, 2010.

### *Net Accounts Receivable*

Accounts receivable (less an allowance for doubtful accounts of approximately \$348,000 and \$186,000 as of Dec. 31, 2010, and 2009, respectively) includes uncollected accounting support fees from issuers and annual fees from registered accounting firms of approximately \$41,000 and \$232,000 as of Dec. 31, 2010, and 2009, respectively. The allowance for doubtful accounts increased significantly in 2010 because the PCAOB factored the balances of bankrupt issuers into the calculation of the reserve.

The collection rates for the annual accounting support fees were approximately 99.9 and 99.7 percent for the years ended Dec. 31, 2010, and 2009, respectively. Approximately 91.8 percent of the 2010 annual fees billed to registered accounting firms was collected as of Dec. 31, 2010.

### *Net Fixed Assets*

Net fixed assets were approximately \$10.7 million and \$9.7 million as of Dec. 31, 2010, and 2009, respectively. Spending on fixed assets increased from \$3.1 million in 2009 to \$5.0 million in 2010. Major fixed asset purchases included the scheduled replacement of certain hardware components at the end of their projected lives, leasehold improvements and furniture for various office expansions, and licenses for the inspections information system. The increase was offset, however, by the continued depreciation of fixed assets, resulting in a net increase of approximately \$1.0 million in fixed assets for 2010.

### *Accounts Payable and Other Liabilities*

Accounts payable and other liabilities consist primarily of payroll-related liabilities, such as accrued employee leave and annual performance awards, and operating expenses. The account balance increased by \$2.5 million from \$11.4 million in 2009 to \$13.9 million in 2010, primarily due to increases in the accrued employee leave liability and in other compensation-related accruals. Employee leave liability increased consistent with increased average leave balances per employee and increased overall headcount.

### *Installment Note Payable*

In 2010, the PCAOB entered into a non interest-bearing installment note payable arrangement with a financial institution to finance the purchase of information technology hardware. The arrangement was part of the contract with the equipment vendor. The balance of the note payable as of Dec. 31, 2010, was approximately \$823,000 and is due in June 2011.

## **Statements of Activities**

### *Operating Revenue*

Total operating revenue increased by approximately \$22.4 million in 2010 compared to 2009. Operating revenue includes the accounting support fee and registration and annual reporting fees from accounting firms.

### *Accounting Support Fee*

The annual accounting support fee is allocated to equity and investment company issuers based on their relative average monthly U.S. equity market capitalization. Equity issuers with a market capitalization greater than \$25 million and investment company issuers with an average monthly market capitalization, or net asset value, greater than \$250 million are invoiced a proportionate share of the accounting support fee. In 2010, equity issuers were assessed approximately 92 percent of the total fees, and investment company issuers were assessed the remaining 8 percent.



## Financial Review

The PCAOB invoiced 9,215 issuers in 2010, compared to 10,164 issuers in 2009. Approximately 38 percent of the issuers billed received invoices for \$1,000 or less. In 2010, the largest 1,000 invoice amounts comprised approximately 84 percent of the total fee. The total number of issuers billed decreased from 10,164 in 2009 to 9,215 in 2010 due to a decrease in the number of issuers with average monthly market capitalizations greater than the thresholds discussed above, which was consistent with economic trends for the billing year.

The following table reflects the distribution of invoiced issuers by fee ranges.

### Number of Issuers

FEE RANGES	2010	2009
\$100-500	1,698	2,906
\$501-1,000	1,788	1,789
\$1,001-5,000	3,012	2,953
\$5,001-10,000	868	850
\$10,001-50,000	1,289	1,147
\$50,001-100,000	251	229
\$100,001-500,000	258	249
\$500,001-1,000,000	27	23
\$1,000,001- 4,000,000	24	18
<b>TOTAL</b>	<b>9,215</b>	<b>10,164</b>

### *Fees from Accounting Firms*

Fees from accounting firms consist of both registration fees and annual reporting fees. In April 2010, the PCAOB invoiced approximately \$1.7 million in annual fees to 2,444 registered accounting firms. The six firms reporting the highest number of issuer audit clients and firm personnel were billed larger fee amounts and collectively accounted for approximately 27 percent

of the total fee. The remaining 2,438 firms accounted for the remaining 73 percent of the total fee, and each received an invoice in the amount of \$500.

The PCAOB also receives one-time registration fees from public accounting firms that register with the PCAOB. In 2010, the PCAOB collected approximately \$118,000 in registration fees and approved the registration of 308 firms. As of Dec. 31, 2010, 2,397 accounting firms were registered with the PCAOB, compared to 2,349 registered firms at the end of 2009.

The following table reflects information related to the invoicing of annual fees for registered accounting firms.

FEE AMOUNT	NUMBER OF FIRMS INVOICED
\$100,000	4
\$25,000	2
\$500	2,438
<b>TOTAL</b>	<b>2,444</b>

### *Other Revenue*

Non-operating revenue includes interest income generated from investments, the annual fee assessed to the FASB for serving as its collection agent, and other miscellaneous income, such as civil monetary penalties.

### *Operating Expenses*

The PCAOB's operating expenses are presented as program and supporting activities in the financial statements. The expenses charged to each program or supporting activity are addressed in the discussion that follows. Because disclosure of functional expenses is a useful complement to this discussion, the following table and accompanying analysis of the PCAOB's functional operating expenses for the years ended Dec. 31, 2010, and 2009 are presented first.

<b>FUNCTIONAL OPERATING EXPENSES</b>	<b>2010</b>	<b>2009</b>
Personnel Costs	\$123,050,000	\$109,255,000
Travel Expenses	9,464,000	7,774,000
Information Technology-Related Expenses	8,889,000	8,438,000
Depreciation	4,084,000	3,969,000
Other Operating Expenses	21,944,000	19,452,000
<b>Total Operating Expenses</b>	<b>\$167,431,000</b>	<b>\$148,888,000</b>

Total operating expenses increased by approximately \$18.5 million in 2010 to \$167.4 million. Personnel costs comprised approximately 74 percent of total operating expenses in 2010 as compared to 73 percent of total operating expenses in 2009. These costs include salaries, employee benefits, training, temporary help, recruiting and relocation. Increases in staffing levels (from 567 employees at the end of 2009 to 600 employees at the end of 2010) and pay increases in 2010 were primarily responsible for the increase in personnel expenses from approximately \$109.3 million in 2009 to \$123.1 million in 2010, an increase of \$13.8 million.

Travel represents a significant expense for the PCAOB since the majority of inspections take place in the offices of the inspected firms. The expense is affected by a number of factors, including the cost of accommodations and airfare, the number of trips taken, and the travel destination. Approximately 92 percent of total travel expenses were related to inspection activity. Total travel expenses increased approximately \$1.7 million, from \$7.8 million in 2009 to \$9.5 million in 2010 primarily due to increases in travel related to inspections activity.

Information technology-related (IT) expenses, which include telecommunications, non-capitalized hardware and maintenance, data storage, non-capitalized software development, and data security maintenance, increased approximately \$500,000 from \$8.4 million in 2009 to \$8.9 million in 2010. The increase was due primarily to increased telecommunications and IT maintenance costs in support of increased staffing and new office locations.

Other operating expenses, which include administrative expenses (such as subscriptions, office supplies, printing and copying, and insurance), professional and consulting fees, and facilities costs, increased approximately \$2.4 million from \$19.5 million in 2009 to \$21.9 million in 2010. The increase was due to several factors including increased facilities costs related to the expansions of existing locations and a full year of operations of the five satellite office locations, increased subscriptions and office supply expenses, and increased consulting expenses, primarily related to expert witnesses supporting enforcement litigation. These increases were partially offset by decreased legal fees for external counsel related to the *Free Enterprise Fund vs. PCAOB* lawsuit, which challenged the constitutionality of the PCAOB's structure.

The following are descriptions of program and supporting activity expenses as presented in the financial statements

### *Program Activities*

The Sarbanes-Oxley Act, as amended, gives the PCAOB four primary responsibilities: registration of accounting firms that audit public companies or SEC-registered broker-dealers; inspection of registered public accounting firms that audit public companies or SEC-registered broker-dealers;<sup>2</sup> establishment of auditing, quality control, ethics, independence and other standards for registered public accounting firms; and investigation and discipline of registered public accounting firms and their associated persons for violations of specified laws or professional standards. These responsibilities are designated as program activities and are reflected as such in the Statements of Activities. The financial statements include two additional program activities: Office of Research and Analysis (ORA) and Board and related activities, which includes the Office of International Affairs (OIA).

Costs associated with program activities totaled approximately \$129.7 million in 2010 (77 percent of total operating expenses) and approximately \$112.5 million in 2009 (76 percent of total operating expenses).

2. In December of 2010, the Board proposed a temporary rule to establish an interim inspection program related to audits of brokers and dealers. The temporary rule will allow the Board to assess registered public accounting firms' current compliance with laws, rules, and standards in performing audits with respect to brokers and dealers and will inform the Board's decisions about significant elements of a permanent inspection program, including whether to differentiate among classes of brokers and dealers, whether to exempt any categories of public accounting firms, and what minimum inspection frequency schedules to establish.

## Financial Review

### *Registration and Inspections*

During 2010, the PCAOB continued to register and inspect public accounting firms. Operating expenses increased approximately \$13.4 million to \$90.7 million in 2010 from \$77.3 million in 2009, due primarily to increased staff and related expenses and increased travel costs.

### *Enforcement*

Formal and informal investigations of registered firms continued in 2010. Operating expenses of the Division of Enforcement and Investigations increased approximately \$2.5 million to \$15.6 million in 2010 from \$13.1 million in 2009. This increase was related primarily to increased staff and related expenses and increased consulting and professional fees needed in support of litigation activity.

### *Standard Setting*

The Office of the Chief Auditor assisted the Board in its standard-setting activities. An overall increase in the office's operating expenses from approximately \$5.9 million in 2009 to approximately \$7.2 million in 2010 was related to increased staff and related expenses.

### *Office of Research and Analysis*

ORA identified and analyzed emerging accounting and auditing issues and other risk areas that could contribute to audit failures. For 2010, the office's operating expenses increased approximately \$1.0 million to \$9.1 million in 2010 from \$8.1 million in 2009. The operating expense increase was related primarily to increased staff and related expenses and increased subscription costs.

### *Board and Related Activities*

Board and related activities comprise the operations of Board members' offices and OIA. Operating expenses for the Board and related activities decreased approximately \$700,000 from \$7.9 million in 2009 to \$7.2 million in 2010. The decrease was primarily attributable to the full-year vacancy in 2010 of the Chairman and Chief of Staff positions and also a reduction in total Board staff.

### *Supporting Activities*

As described below, supporting activities included administration and general expenditures, communications, and information technology. In 2010, these activities comprised approximately 23 percent of the total operating expenses of the PCAOB compared to approximately 24 percent in 2009. Total operating expenses of the supporting activities increased by approximately \$1.3 million from \$36.4 million in 2009 to \$37.7 million in 2010.

### *Administration and General*

Administration and general operating expenses consisted of expenses related to human resources, finance, general counsel, hearing officer, budget office, compliance and risk management, administration, and internal oversight and performance assurance. Collectively, operating expenses in these areas increased approximately \$1.2 million from \$16.8 million in 2009 to \$18.0 million in 2010. The increase was attributable to increased personnel costs, occupancy costs and office supplies. Decreased legal services related to the *Free Enterprise Fund* lawsuit partially offset the overall increase.

### *Communications*

Communications included expenses related to external relations initiatives, including public affairs, government relations and Forums on Auditing in the Small Business Environment. Operating expenses decreased approximately \$600,000 to \$2.7 million in 2010 from \$3.3 million in 2009, due primarily to decreased professional fees related to the redesign of the PCAOB's website.

### *IT Infrastructure, Security and Telecommunications*

Expenses for IT infrastructure, security and telecommunications include personnel costs and depreciation that were not directly attributable to program activities. In 2010, operating expenses increased approximately \$500,000 to \$17.0 million from \$16.5 million in 2009. This increase was due to an increased staff and related expenses, maintenance and telecommunications costs.

# Independent Auditor's Report

To the Board of the  
Public Company Accounting Oversight Board  
Washington, D.C.

We have audited the accompanying statements of financial position of the Public Company Accounting Oversight Board (PCAOB) as of December 31, 2010, and 2009, and the related statements of activities and cash flows for the years then ended. We have also audited the Board's internal control over financial reporting as of December 31, 2010 based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee on Sponsoring Organizations of the Treadway Commission (COSO). The PCAOB's financial reporting management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Financial Reporting Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on these financial statements and an opinion on the PCAOB's internal control over financial reporting based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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 also includes examining, on a test basis, evidence supporting the amounts and disclosures in financial statements, 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.

We conducted our audit of the internal control over financial reporting in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America and that receipts and expenditures of the company are being made only in accordance with authorizations of management of the



## Independent Auditor's Report

company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisitions, use or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with policies or procedures may deteriorate.

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, 2010, and 2009, and the changes in its net assets and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the Public Company Accounting Oversight Board maintained, in all material respects, effective internal control over financial reporting as of December 31, 2010, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee on Sponsoring Organizations of the Treadway Commission (COSO).

*Blum, Shapiro & Company, P.C.*

West Hartford, Connecticut

May 17, 2011

# Statements of Financial Position

DECEMBER 31, 2010 and 2009

	2010	2009
<b>ASSETS</b>		
Cash and cash equivalents (Note 2)	\$ 20,598,551	\$ 85,926,449
Short-term investments (Note 2)	79,986,200	—
Accounts receivable, net of allowance (Note 4)	41,208	232,096
Prepaid expenses and other assets, net of allowance	4,698,008	5,099,773
Furniture and equipment, leasehold improvements and technology, net (Note 5)	10,690,395	9,715,437
<b>Total Assets</b>	<b>\$116,014,362</b>	<b>\$100,973,755</b>
<b>LIABILITIES AND NET ASSETS</b>		
<b>Liabilities</b>		
Accounts payable and other liabilities	\$ 13,850,607	\$ 11,400,202
Installment note payable (Note 6)	822,890	—
Obligations under capital leases (Note 7)	105,650	114,291
Deferred rent (Note 8)	6,162,447	7,217,601
Total liabilities	20,941,594	18,732,094
<b>Unrestricted Net Assets</b>		
Undesignated	93,961,571	81,130,512
Statutorily designated for specific uses in Section 109(c)(2) of the Sarbanes-Oxley Act (Note 2)	1,111,197	1,111,149
Total Net Assets	95,072,768	82,241,661
<b>Total Liabilities and Net Assets</b>	<b>\$116,014,362</b>	<b>\$100,973,755</b>

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

# Statements of Activities

FOR THE YEARS ENDED DECEMBER 31, 2010 and 2009

	2010	2009
<b>Changes in Unrestricted Net Assets</b>		
Operating revenue:		
Fees from issuers (Note 2)	\$177,986,370	\$157,133,040
Fees from registering accounting firms (Note 2)	1,698,250	169,000
Total operating revenue	179,684,620	157,302,040
Operating expenses:		
Program activities:		
Registration and inspections (Note 2)	90,661,945	77,289,978
Enforcement (Note 2)	15,613,605	13,101,328
Standards setting (Note 2)	7,191,839	5,908,451
Research and analysis (Note 2)	9,056,129	8,073,244
Board and related activities (Note 2)	7,152,514	7,915,084
Supporting activities:		
Administrative and general	18,006,130	16,780,641
Communications	2,714,480	3,341,400
IT infrastructure, security and telecommunications	17,034,050	16,477,871
Total operating expenses	167,430,692	148,887,997
<b>Operating Income</b>	12,253,928	8,414,043
<b>Other Revenue</b>		
Interest income and other	577,131	572,574
Net civil monetary penalties and interest (Note 2)	48	76,658
Total other revenue	577,179	649,232
<b>Increase in Unrestricted Net Assets</b>	12,831,107	9,063,275
<b>Unrestricted Net Assets—Beginning of Year</b>	82,241,661	73,178,386
<b>Unrestricted Net Assets—End of Year</b>	\$ 95,072,768	\$ 82,241,661

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

# Statements of Cash Flows

FOR THE YEARS ENDED DECEMBER 31, 2010 and 2009

	2010	2009
<b>Cash Flows from Operating Activities</b>		
Cash received from issuers	\$ 178,183,758	\$ 157,036,707
Cash received from accounting firms	1,691,750	169,000
Interest income and other	577,131	572,574
Net civil monetary penalties and interest	48	76,658
Cash paid to suppliers and employees	(161,549,254)	(146,069,704)
Net cash provided by operating activities	18,903,433	11,785,235
<b>Cash Flows from Investing Activities</b>		
Purchases of furniture and equipment, leasehold improvements and technology	(4,245,131)	(3,040,607)
Proceeds from sale of furniture and equipment	—	13,389
Purchases of short-term investments	(89,849,555)	(34,997,108)
Proceeds from maturity of short-term investments	9,863,355	69,990,808
Net cash provided (used) by investing activities	(84,231,331)	31,966,482
<b>Net Increase (Decrease) in Cash and Cash Equivalents</b>	(65,327,898)	43,751,717
<b>Cash and Cash Equivalents—Beginning of Year</b>	85,926,449	42,174,732
<b>Cash and Cash Equivalents—End of Year</b>	\$ 20,598,551	\$ 85,926,449
<b>Reconciliation of Increase in Unrestricted Net Assets to Net Cash Provided by Operating Activities</b>		
Increase in unrestricted net assets	12,831,107	9,063,275
Reconciliation adjustments:		
Depreciation and amortization	4,084,422	3,969,119
(Increase) decrease in accounts receivable, net of allowance	190,888	(96,333)
(Increase) decrease in prepaid expenses and other assets	401,765	(1,612,153)
Increase in accounts payable and other liabilities	2,450,405	957,000
Decrease in deferred rent	(1,055,154)	(495,673)
<b>Net Cash Provided by Operating Activities</b>	\$ 18,903,433	\$ 11,785,235

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



# Notes to the Financial Statements

## Note 1. Nature of Activities

The Public Company Accounting Oversight Board (the PCAOB) was established by the Sarbanes-Oxley Act of 2002, as amended (the Act) to oversee the auditors of U.S. listed public companies in order to protect the interests of investors and further the public interest in the preparation of informative, accurate and independent audit reports. The Act established the PCAOB as a private, non-profit corporation.

Under the Act, the U.S. Securities and Exchange Commission (the SEC) has oversight over the PCAOB, including the appointment of Board members, approval of PCAOB rules and standards, and review of the PCAOB's actions and its operations. The PCAOB's annual budget must be approved by the SEC under the Act. As part of the budget process and pursuant to the Act, the Board establishes and the SEC approves an annual accounting support fee to maintain the operations of the PCAOB.

Section 982 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act), signed into law on July 21, 2010, amended the Act to provide the PCAOB with the authority to oversee auditors of brokers and dealers registered with the SEC (SEC-registered broker-dealers) including inspections, enforcement and standard setting authority. With respect to the inspection authority, the Dodd-Frank Act authorizes the PCAOB to prescribe by rule a specific program of inspection of registered public accounting firms that provide an audit report for a SEC-registered broker-dealer.

## Note 2. Summary of Significant Accounting Policies

**Presentation.** The financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and are presented pursuant to the Accounting Standards Codification Topic 958, *Not-for-Profit Entities* (ASC 958). Under ASC 958, 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 any donor-imposed restrictions, and, therefore, all have been classified as unrestricted in the accompanying statements. In addition, the PCAOB reports unrestricted net assets that are statutorily designated for specified uses. These assets consist of all funds generated from the collection of civil monetary penalties and any interest earnings thereon. Pursuant to Section 109(c)(2) of the Act, all funds generated from the collection of penalties shall be used, exclusively, to fund a scholarship program.

The PCAOB's unrestricted net assets consist primarily of amounts to fund operations in the subsequent year prior to collection of that year's accounting support fees and the organization's investments in fixed assets, particularly technology hardware and software. The PCAOB's operations consist of program activities and supporting activities. The program activities of the PCAOB are: registration and inspections, enforcement, standards setting, research and analysis, and Board and related activities. Costs associated with these program activities include salaries, benefits, rent, program-specific technology costs and other direct operating expenses. Indirect costs are not allocated to program activities, but are included in supporting activities.

## Program Activities of the PCAOB

**Registration and Inspections.** Under the Act and the PCAOB's rules, a public accounting firm must be registered with the PCAOB if it prepares or issues, or plays a substantial role in the preparation or furnishing of, any audit report with respect to an issuer or SEC-registered broker-dealer. The PCAOB reviews the registration application of each public accounting firm that seeks to register with the PCAOB. If the PCAOB Board approves its application, that registered public accounting firm is subject to the PCAOB's rules and continuing program of inspections. This

program assesses firms' compliance with the Act, the rules of the PCAOB and the rules of the SEC, as well as professional standards, in connection with firms' performance of audits, issuance of audit reports and related matters involving issuers.

**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 and remedial sanctions, including civil monetary penalties, when it determines that the laws, rules or standards within the PCAOB's jurisdiction have been violated.

**Standard Setting.** The PCAOB establishes auditing, related attestation, quality control, independence and ethics standards and rules to be followed by registered public accounting firms in the preparation and issuance of audit reports.

**Research and Analysis.** The PCAOB's Office of Research and Analysis collects, analyzes and assimilates information from multiple sources and provides other PCAOB divisions and offices with assessments of risks that may affect audit quality.

**Board and Related Activities.** In accordance with the Act, the PCAOB Board is responsible for carrying out the PCAOB's programs and operations. The Board is responsible for determining the PCAOB's action in each program area, as well as for performing such other duties or functions as the 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 addition, the Board engages in communication and other outreach efforts with the accounting profession, the investing public, public companies, audit committees, SEC-registered broker-dealers and other U.S. and non-U.S. regulators concerning, among other things, the PCAOB's mission, programs, initiatives and its oversight of the accounting profession. Also included in Board and Related Activities is the PCAOB's Office of International Affairs. This office represents the PCAOB in bilateral and multilateral discussions with non-U.S. authorities primarily regarding inspections of foreign registered public accounting firms.

**Use of Estimates.** The preparation of financial statements in accordance with U.S. generally accepted accounting principles requires financial reporting 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. Actual results could differ from these estimates.

**Fair Value of Financial Instruments.** The fair values of cash and cash equivalents, accounts receivable, accounts payable, and notes payable approximate their carrying values due to the short-term nature of these items.

**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 operations of the PCAOB. Such fees are recognized as operating revenue in the budget year to which they relate. The amount of the fees invoiced to individual issuers 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 Accounting Firms.** Effective in 2010, the Board established that all registered public accounting firms are required to file annual reports, file timely special reports if certain specified events occur, and pay an annual fee. The annual fee covers all costs related to the review and processing of the reports and any costs related to processing and reviewing registration applications not covered by registration application fees. All accounting firms registered with the PCAOB as of March 31, 2010 were assessed an annual fee based on the firm's number of issuer audit clients and personnel.

Application fees from registering accounting firms are applied to cover 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 application fees and annual fees from accounting firms as an increase in unrestricted net assets, and all such fees are

## Notes to the Financial Statements

recognized as operating revenue in the budget year to which they relate. In 2010, along with the establishment of the annual fee, the Board increased the minimum fee for registration applications.

**Net Civil Monetary Penalties and Interest.** PCAOB sanction orders that took effect in August 2009 and December 2010 imposed civil monetary penalties pursuant to the Board's authority under Section 105 of the Act. In each case, the amount of the civil monetary penalty was \$75,000 for the years ended December 31, 2010, and 2009. In accordance with Section 109(c)(2) of the Act, all funds generated from the collection of civil monetary penalties are to be used, exclusively, to fund a "merit scholarship program for undergraduate and graduate students enrolled in accredited accounting degree programs." Where applicable, the PCAOB records a reserve against civil monetary penalties ordered, but not yet collected. The PCAOB reports all funds generated from the collection of civil monetary penalties (including related interest income) as increases in unrestricted net assets statutorily designated for specified uses in Section 109(c)(2) of the Act.

**Cash Held for Others under Agency Agreement.** The PCAOB served as the collection agent for invoicing and collecting the 2010 and 2009 accounting support fee for the Financial Accounting Standards Board (the FASB). The PCAOB's fee for acting as the FASB's collection agent was \$209,400 in both 2010 and 2009. 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, 2010, and 2009, the PCAOB had \$25,886 and \$9,914, respectively, included in cash and cash equivalents related to the FASB. Corresponding amounts are included in accounts payable and other liabilities for amounts due to the FASB as of December 31, 2010, and 2009.

**Cash and Cash Equivalents.** The term cash and cash equivalents, as used in the accompanying financial statements, includes demand deposits and overnight investment accounts with

financial institutions, and short-term, highly liquid investments purchased with a maturity of three months or less. Cash and cash equivalents included approximately \$1.1 million as of December 31, 2010, and 2009 related to the collection of civil monetary penalties for disciplinary actions including accrued interest.

The PCAOB maintains substantially all its cash and cash equivalents, which exceed federally insured limits, with a major financial institution.

**Short-Term Investments.** Short-term investments include investments in U.S. Treasury bills. As of December 31, 2010, the treasury bills were valued at \$79,986,200. Interest income earned on these investments was \$158,085 and \$37,242, during the years ended December 31, 2010, and 2009, respectively. Due to a change in its investment strategy, the PCAOB had no investment in Treasury bills as of December 31, 2009.

**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 three to five years. Leasehold improvements and assets related to capital leases are amortized over the shorter of their estimated useful lives or the remaining terms of the leases.

**Taxes.** The PCAOB is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code of 1986, as amended. 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, the PCAOB will take appropriate steps to establish that it is not subject to state and local taxes in the relevant jurisdiction, pursuant to the Act.

**Reclassification.** Certain amounts in the prior period presented have been reclassified to conform to the current period financial statement presentation. These reclassifications have no effect on previously reported net income.

**Subsequent Events.** In preparing these financial statements, financial reporting management has evaluated subsequent events through May 17, 2011, which represents the date the financial statements were available to be issued.

### Note 3. Fair Value of Financial Instruments

Short-term investments include investments in U.S. Treasury bills with maturities of six months or less from the purchase date. These investments are reported at fair value, which was determined using quoted market prices in active markets for identical assets and shown in the table below as of December 31, 2010, and 2009:

	2010	2009
Investments in U.S. Treasury Bills		
Carrying amount	\$79,986,200	\$-
Quoted prices in active markets for identical assets	\$79,986,200	\$-

### Note 4. Accounts Receivable

Accounts receivable consists of the following as of December 31, 2010, and 2009:

	2010	2009
Accounts receivable—issuers	\$ 334,675	\$412,248
Accounts receivable— accounting firms	54,500	5,750
	389,175	417,998
Less allowance for doubtful accounts	(347,967)	(185,902)
Accounts receivable, net	\$ 41,208	\$232,096

The allowance for doubtful accounts is an estimate based on financial reporting, management's review and the PCAOB's historical experience.

### Note 5. Furniture and Equipment, Leasehold Improvements and Technology

These assets consist of the following as of December 31, 2010, and 2009:

	2010	2009
Technology:		
Hardware	\$ 11,794,354	\$ 11,187,380
Purchased and developed software	29,764,350	29,725,537
Leasehold improvements	12,023,158	10,610,933
Furniture and equipment	8,123,015	7,626,895
Technology development and construction in process	86,260	251,793
Total	61,791,137	59,402,538
Accumulated depreciation and amortization	(51,100,742)	(49,687,101)
	\$ 10,690,395	\$ 9,715,437

Depreciation and amortization expense was \$4,084,422 and \$3,969,119 for the years ended December 31, 2010, and 2009, respectively.

### Note 6. Installment Note Payable

Installment note payable as of December 31, 2010 consisted of the following:

	2010	2009
Non-interest bearing installment note payable to bank, secured by \$1.6 million of related equipment, due by June 2011	\$822,890	\$-
Total	\$822,890	\$-

The above installment note was a non-cash transaction upon issuance and is not included in the statements of cash flows.



## Notes to the Financial Statements

**Note 7. Obligations Under Capital Leases**

In 2010, the PCAOB entered into agreements to lease certain office equipment. The PCAOB has accounted for these leases as capital leases in accordance with Accounting Standards Codification Topic 840 *Leases*. The cost of the equipment under capital leases is included in the statements of financial position as furniture and equipment, leasehold improvement and technology and was \$259,956 and \$184,937 as of December 31, 2010, and 2009, respectively. Accumulated amortization of the leased equipment was \$74,149 and \$77,978 as of December 31, 2010, and 2009, respectively. Amortization of assets under capital leases is included in depreciation and amortization expense.

Minimum lease payments due are as follows:

Total minimum lease payments required	\$108,928
Less amount representing interest	(3,278)
Present value of minimum lease payments	\$105,650

**YEARS ENDING DECEMBER 31,**

2011	\$ 66,383
2012	38,969
2013	3,576
	\$108,928

Interest expense related to the capital lease transactions was \$5,844 and \$6,331 for the years ended December 31, 2010, and 2009, respectively.

**Note 8. Lease Commitments**

As of December 31, 2010, the PCAOB occupied office space in Washington, DC; New York, NY; Ashburn, VA; San Mateo, CA; Irvine, CA; Atlanta, GA; Dallas, TX; Chicago, IL; and Denver, CO, under leases that expire from 2013 to 2017. The

PCAOB also occupied temporary office space in Charlotte, NC; Boston, MA; Houston, TX; Tampa, FL; and Troy, MI, under leases that expire no later than 2011. These operating leases include provisions for scheduled rent increases over the respective terms and several include renewal options at the end of the lease terms, which are subject to approval by both parties.

Rent is being expensed using the straight-line method over the respective lease terms. Rent expense under this method was \$10,413,829 and \$9,179,375 for the years ended December 31, 2010, and 2009, respectively. Deferred rent that has been expensed but will not be paid until future years totaled \$6,162,447 and \$7,217,601 as of December 31, 2010, and 2009, respectively, and is being amortized over the remaining lives of the office leases.

Minimum rental commitments under the office leases as of December 31, 2010, are as follows:

**YEAR ENDING DECEMBER 31,**

2011	\$10,107,081
2012	10,351,913
2013	8,225,916
2014	3,839,732
2015	1,080,253
Thereafter	694,472
	\$34,299,367

**Note 9. Retirement Benefit Plan**

The PCAOB has a defined contribution retirement plan which covers active employees. For the years ended December 31, 2010, and 2009, the PCAOB matched 100% of employee contributions up to 7% of the eligible compensation. The PCAOB's contributions become fully vested immediately. The PCAOB's contributions to employees' accounts were \$6,006,463 and \$4,991,105 for the years ended December 31, 2010, and 2009, respectively.

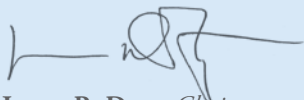
# Financial Reporting Management's Report on Internal Control Over Financial Reporting

The PCAOB's financial reporting management, including the Chief Administrative Officer, Deputy Chief Administrative Officer, and the Director of Finance, under the direction of the Chairman (collectively, "financial reporting management") are responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

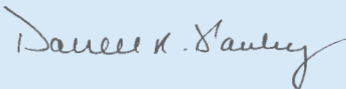
Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

The PCAOB's financial reporting management assessed the effectiveness of the PCAOB's internal control over financial reporting as of December 31, 2010. In making this assessment, financial reporting management used the criteria established in *Internal Control—Integrated Framework*, issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on its assessment, the PCAOB's financial reporting management concluded that the organization's internal control over financial reporting is effective as of December 31, 2010.

May 17, 2011



**James R. Doty**, *Chairman*



**Darrell Pauley**, *Chief Administrative Officer*



**William F. Wiggins**, *Deputy Chief Administrative Officer*



**Bela Daruwala**, *Director of Finance*

# Board Releases and Staff Guidance Issued in 2010

## FIRST QUARTER

DOCUMENT	DOCUMENT NO.	DATE
Staff Questions and Answers: Registration of Broker-Dealer Auditors	n/a	Jan. 12, 2010
Staff Questions and Answers: Special Reporting on Form 3	n/a	Jan. 12, 2010
Staff Questions and Answers: Succession to Registration Status—Form 4	n/a	Jan. 12, 2010
Order Making Findings and Disapproving Registration Application in re Registration Application of Davis, Graber, Plotzker and Ward, LLP	PCAOB Release No. 102-2010-001	Jan. 19, 2010
Order Granting Petition to Terminate Bar and Consenting to Association with a Registered Public Accounting Firm in the Matter of Stephen J. Nardi, CPA	PCAOB Release No. 105-2010-001	Feb. 12, 2010
Order Making Findings and Imposing Sanctions in the Matter of Jennifer Nakao, CPA	PCAOB Release No. 105-2010-002	Feb. 17, 2010
Order Making Findings and Imposing Sanctions in the Matter of Ray O Westergard, CPA	PCAOB Release No. 105-2010-003	Feb. 17, 2010
Staff Question and Answer: Auditing Standard No. 7, <i>Engagement Quality Review</i>	n/a	Feb. 19, 2010
Order Making Findings and Disapproving Registration Application in re Registration Application of Price & Gartrell, P.C.	PCAOB Release No. 102-2010-002	March 1, 2010
Order Instituting Disciplinary Proceedings, Making Findings, and Imposing Sanctions in the Matter of Siva Prasad Pulavarthi	PCAOB Release No. 105-2010-004	March 16, 2010
Order Instituting Disciplinary Proceedings, Making Findings, and Imposing Sanctions in the Matter of Chintapatla Ravindernath	PCAOB Release No. 105-2010-005	March 16, 2010
Proposed Auditing Standard Related to Communications with Audit Committees and Related Amendments to Certain PCAOB Auditing Standards	PCAOB Release No. 2010-001	March 29, 2010

## SECOND QUARTER

DOCUMENT	DOCUMENT NO.	DATE
Staff Audit Practice Alert No. 5: Auditor Considerations Regarding Significant Unusual Transactions	n/a	April 7, 2010
Announcement of Annual Fee and Increase in Minimum Registration Application Fee	PCAOB Release No. 2010-002	April 13, 2010
Order Instituting Disciplinary Proceedings, Making Findings, and Imposing Sanctions in the Matter of Robert T. Taylor, CPA and Robert T. Taylor, CPA	PCAOB Release No. 105-2010-006	April 27, 2010
Update to Frequently Asked Questions Regarding Registration with the Board	PCAOB Release No. 2003-011D	April 28, 2010
Order Making Findings and Disapproving Registration Application in re Registration Application of HHH CPA Group, LLC	PCAOB Release No. 102-2010-003	June 1, 2010
Update to Frequently Asked Questions Regarding Issues Relating to Non-U.S. Accounting Firms	n/a	June 1, 2010
Order Making Findings and Disapproving Registration Application in re Registration Application of Hansen, Plahm & Company	PCAOB Release No. 102-2010-004	June 9, 2010
Staff Questions and Answers: Annual Reporting on Form 2	n/a	June 18, 2010



## Board Releases and Staff Guidance Issued in 2010

## THIRD QUARTER

DOCUMENT	DOCUMENT NO.	DATE
Staff Audit Practice Alert No. 6: Auditor Considerations Regarding Using the Work of Other Auditors and Engaging Assistants from Outside the Firm	n/a	July 12, 2010
Proposed Auditing Standard Related to Confirmation and Related Amendments to PCAOB Standards	PCAOB Release No. 2010-003	July 13, 2010
Order Making Findings and Disapproving Registration Application in re Registration Application of Apple Accounting A Financial Services LLC	PCAOB Release No. 102-2010-005	July 13, 2010
Order Making Findings and Disapproving Registration Application in re Registration Application of John A. Matthews Jr., C.P.A., P.C.	PCAOB Release No. 102-2010-006	July 13, 2010
Order Making Findings and Disapproving Registration Application in re Registration Application of Richard J. Sheeler & Co., LLP	PCAOB Release No. 102-2010-007	July 13, 2010
Adopting Release—Auditing Standard Nos. 8-15, <i>Auditor's Assessment of and Response to Risk and Related Amendments to PCAOB Standards</i>	PCAOB Release No. 2010-004	Aug. 5, 2010
Release on the Application of the "Failure to Supervise" Provision of the Sarbanes-Oxley Act of 2002 and Solicitation of Comment on Rulemaking Concepts	PCAOB Release No. 2010-005	Aug. 5, 2010
Order Making Findings and Disapproving Registration Application in re Registration Application of Bobrow & Company, P.C.	PCAOB Release No. 102-2010-008	Aug. 12, 2010
Order Instituting Disciplinary Proceedings, Making Findings, and Imposing Sanctions in the Matter of Traci Jo Anderson and Traci Jo Anderson, CPA	PCAOB Release No. 105-2010-007	Aug. 12, 2010
Order Making Findings and Disapproving Registration Application in re Registration Application of Flax and Company, P.C.	PCAOB Release No. 102-2010-009	Sept. 8, 2010
Report on Observations of PCAOB Inspectors Related to Audit Risk Areas Affected by the Economic Crisis	PCAOB Release No. 2010-006	Sept. 29, 2010

## FOURTH QUARTER

<b>DOCUMENT</b>	<b>DOCUMENT NO.</b>	<b>DATE</b>
Consideration of Registration Applications From Public Accounting Firms in Non-U.S. Jurisdictions Where There are Unresolved Obstacles to PCAOB Inspections	PCAOB Release No. 2010-007	Oct. 7, 2010
Adjudicated Disciplinary Order in the Matter of Larry O'Donnell, CPA, P.C. and Larry O'Donnell, CPA	PCAOB File No. 105-2010-002	Oct. 19, 2010
Order Instituting Disciplinary Proceedings, Making Findings, and Imposing Sanctions in the Matter of Jacqueline A. Higgins, CPA	PCAOB Release No. 105-2010-008	Dec. 3, 2010
Proposed Temporary Rule for an Interim Program of Inspection Related to Audits of Brokers and Dealers	PCAOB Release No. 2010-008	Dec. 14, 2010
Proposal for Allocation of the Board's Accounting Support Fee Among Issuers, Brokers, and Dealers, and Other Amendments to the Board's Funding Rules	PCAOB Release No. 2010-009	Dec. 14, 2010
Staff Audit Practice Alert No. 7: Auditor Considerations of Litigation and Other Contingencies Arising from Mortgage and Other Loan Activities	n/a	Dec. 20, 2010

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(from left to right) Jay D. Hanson, Daniel L. Goelzer, James R. Doty, Steven B. Harris, Lewis H. Ferguson

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*Special Advisor*

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# PCAOB

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Public Company Accounting Oversight Board

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