

**DATES:** Comments must be received by June 22, 2004.

**ADDRESSES:** Copies of the subject form and the request for review prepared for submission to OMB may be obtained from the Agency Submitting Officer. Comments on the form should be submitted to the Agency Submitting Officer.

**FOR FURTHER INFORMATION CONTACT:** OPIC Agency Submitting Officer: Bruce I. Campbell, Records Management Officer, Overseas Private Investment Corporation, 1100 New York Avenue, NW., Washington, DC 20527; 202/336-8563.

### Summary Form Under Review

*Type of Request:* Form Renewal.

*Title:* Request for Registration for Political Risk Investment Insurance.

*Form Number:* OPIC-50.

*Frequency of Use:* Once per investor per project.

*Type of Respondents:* Business or other institution (except farms); individuals.

*Description of Affected Public:* U.S. companies or citizens investing overseas.

*Reporting Hours:* ½ hour per project.

*Number of Responses:* 343 per year.

*Federal Cost:* \$1,000.00.

*Authority for Information Collection:* Sections 231, 234(a), 239(d), and 240A of the Foreign Assistance Act of 1961, as amended.

*Abstract (Needs and Uses):* The OPIC 50 form is submitted by eligible investors to register their intent to make international investments, and ultimately, to seek OPIC political risk insurance. By submitting Form 50 to OPIC prior to making an irrevocable commitment, the incentive effect of OPIC is demonstrated.

Dated: April 20, 2004.

**Eli Landy,**

Senior Counsel, Administrative Affairs,  
Department of Legal Affairs.

[FR Doc. 04-9228 Filed 4-22-04; 8:45 am]

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-49579; File No. PCAOB-2003-08]

### Public Company Accounting Oversight Board; Notice of Filing of Proposed Rule and Form Relating to Inspections of Registered Public Accounting Firms

April 19, 2004.

Pursuant to Section 107(b) of the Sarbanes-Oxley Act of 2002 ("Act"),

notice is hereby given that on October 15, 2003, the Public Company Accounting Oversight Board ("Board" or "PCAOB") filed with the Securities and Exchange Commission ("Commission") the proposed rules described in Items I and II below, which items have been prepared by the Board and are presented here in the form submitted by the Board. The Commission is publishing this notice to solicit comments on the proposed rules from interested persons.

### I. Board's Statement of the Terms of Substance of the Proposed Rules

On October 7, 2003, the Board adopted rules related to inspections. The proposal includes ten Rules on Inspections (PCAOB Rules 4000 through 4010, reserving Rule 4005) and 2 definitions that would appear in PCAOB Rule 1001. The text of the proposed rules and definitions is as follows:

#### Section 1. General Provisions

Rule 1001. Definitions of Terms Employed in Rules

When used in Rules, unless the context otherwise requires:

(a)(xi) Appropriate State Regulatory Authority

The term "appropriate state regulatory authority" means the State agency or other authority responsible for the licensure or other regulation of the practice of accounting in the State or States having jurisdiction over a registered public accounting firm or associated person thereof, with respect to the matter in question.

(p)(vi) Professional Standards

The term "professional standards" means—

(A) accounting principles that are—  
(i) Established by the standard setting body described in section 19(b) of the Securities Act of 1933, as amended by the Act, or prescribed by the Commission under section 19(a) of the Securities Act of 1933 or section 13(b) of the Securities Exchange Act of 1934; and

(ii) Relevant to audit reports for particular issuers, or dealt with in the quality control system of a particular registered public accounting firm; and  
(B) Auditing standards, standards for attestation engagements, quality control policies and procedures, ethical and competency standards, and independence standards (including rules implementing Title II of the Act) that the Board or the Commission determines—

(i) Relate to the preparation or issuance of audit reports for issuers; and

(ii) Are established or adopted by the Board under section 103(a) of the Act, or are promulgated as rules of the Commission.

### Section 4. Inspections

#### Rule 4000. General

Every registered public accounting firm shall be subject to all such regular and special inspections as the Board may from time-to-time conduct in order to assess the degree of compliance of each registered public accounting firm and associated persons of that firm with the Act, the Board's rules, the rules of the Commission, and professional standards, in connection with its performance of audits, issuance of audit reports, and related matters involving issuers. Inspection steps and procedures shall be performed by the staff of the Division of Registration and Inspections, and by such other persons as the Board may authorize to participate in particular inspections or categories of inspections.

#### Rule 4001. Regular Inspections

In performing a regular inspection, the staff of the Division of Registration and Inspections and any other person authorized by the Board to participate in the inspection shall take such steps, and perform such procedures, as the Board determines are necessary or appropriate. Such steps and procedures must include, but need not be limited to, those set forth in Section 104(d)(1) and (2) of the Act and such other tests of the audit, supervisory, and quality control procedures of the firm as the Director of the Division of Registration and Inspections or the Board determines.

#### Rule 4002. Special Inspections

In performing a special inspection, the staff of the Division of Registration and Inspections and any other person authorized by the Board to participate in the inspection shall take such steps, and perform such procedures, as are necessary or appropriate concerning the issue or issues specified by the Board in connection with its authorization of the special inspection.

**Note:** Under Section 104(b)(2) of the Act, the Board may authorize a special inspection on its own initiative or at the request of the Commission.

#### Rule 4003. Frequency of Inspections

During each calendar year, beginning no later than the calendar year following the calendar year in which its application for registration with the Board is approved, a registered public accounting firm that, during the prior calendar year, issued audit reports with

respect to more than 100 issuers shall be subject to a regular inspection.

At least once in every three calendar years, beginning with the three-year period following the calendar year in which its application for registration with the Board is approved, a registered public accounting firm that, during any of the three prior calendar years, issued an audit report with respect to at least one but no more than 100 issuers, or that played a substantial role in the preparation or furnishing of an audit report with respect to at least one issuer, shall be subject to a regular inspection.

With respect to a registered public accounting firm that has filed a completed Form 1-WD under Rule 2107, the Board shall have the discretion to forego any regular inspection that would otherwise commence during the period beginning on the fifth day following the filing of the completed Form 1-WD and continuing until the firm's registration is deemed withdrawn or the firm withdraws the Form 1-WD.

#### Rule 4004. Procedure Regarding Possible Violations

If the Board determines that information obtained by the Board's staff during any inspection indicates that the registered public accounting firm subject to such inspection, any associated person thereof, or any other person, may have engaged, or may be engaged, in any act, practice, or omission to act that is or may be in violation of the Act, the rules of the Board, any statute or rule administered by the Commission, the firm's own quality control policies, or any professional standard, the Board shall, if it determines appropriate—

Report information concerning such act, practice, or omission to—the Commission; and each appropriate state regulatory authority; and Commence an investigation of such act, practice, or omission in accordance with Section 105(b) of the Act and the Board's rules thereunder or a disciplinary proceeding in accordance with Section 105(c) of the Act and the Board's rules thereunder.

**Note:** The Board may, as appropriate, make referrals or report information to regulatory and law enforcement agencies other than those specifically described in Rule 4004.

#### Rule 4005. Record Retention and Availability [Reserved]

#### Rule 4006. Duty to Cooperate With Inspectors

Every registered public accounting firm, and every associated person of a registered public accounting firm, shall

cooperate with the Board in the performance of any Board inspection. Cooperation shall include, but is not limited to, cooperating and complying with any request, made in furtherance of the Board's authority and responsibilities under the Act, to—

(1) Provide access to, and the ability to copy, any record in the possession, custody, or control of such firm or person, and

(2) Provide information by oral interviews, written responses, or otherwise.

#### Rule 4007. Procedures Concerning Draft Inspection Reports

(a) The Director of the Division of Registration and Inspections shall make a draft inspection report available for review by the firm that is the subject of the report. The firm may, within the 30 days after the draft inspection report is first made available for the firm's review, or such longer period as the Board may order, submit to the Board a written response to the draft report.

(b)(1) In submitting a response pursuant to paragraph (a), the firm may indicate any portions of the response for which the firm requests confidential treatment under Section 104(f) of the Act, and may supply any supporting authority or other justification for according confidential treatment to the information.

(2) The Board shall attach to, and make part of the inspection report, any response submitted pursuant to paragraph (a), but shall redact from the response attached to the inspection report any information for which the firm requested confidential treatment and which it is reasonable to characterize as confidential.

(c) After receiving and reviewing any response letter pursuant to paragraph (a) of this rule, the Board may take such action with respect to the draft inspection report as it considers appropriate, including adopting the draft report as the final report, revising the draft report, or continuing or supplementing the inspection before issuing a final report. In the event that, prior to issuing a final report, the Board directs the staff to continue or supplement the inspection or revise the draft report, the Board may, in its discretion, afford the firm the opportunity to review any revised draft inspection report.

#### Rule 4008. Procedures Concerning Final Inspection Reports

Promptly following the Board's issuance of a final inspection report, the Board shall—

(a) Make the final report available for review by the firm that is the subject of the report;

(b) Transmit to the Commission the final report, any additional letter or comments by the Board or the Board's inspectors that the Board deems appropriate, and any response submitted by the firm to a draft inspection report; and

(c) Transmit to each appropriate state regulatory authority, in appropriate detail, the final report, any additional letter or comments by the Board or the Board's inspectors that the Board deems appropriate, and any response submitted by the firm to a draft inspection report.

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

(a) With respect to any final inspection report that contains criticisms of, or potential defects in, the quality control systems of the firm under inspection, the firm may submit evidence or otherwise demonstrate to the Director of the Division of Registration and Inspections that it has improved such systems, and remedied such defects no later than 12 months after the issuance of the Board's final inspection report. After reviewing such evidence, the Director shall advise the firm whether he or she will recommend to the Board that the Board determine that the firm has satisfactorily addressed the criticisms or defects in the quality control system of the firm identified in the final inspection report and, if not, why not.

(b) If the Board determines that the firm has satisfactorily addressed the criticisms or defects in the quality control system, the Board shall provide notice of that determination to the Commission and to any appropriate state regulatory authority to which the Board had supplied any portion of the final inspection report.

(c) The Board shall notify the firm of its final determination concerning whether the firm has addressed the criticisms or defects in the quality control system of the firm identified in the final inspection report to the satisfaction of the Board.

(d) The portions of the Board's inspection report that deal with criticisms of or potential defects in quality control systems that the firm has not addressed to the satisfaction of the Board shall be made public by the Board—

(1) Upon the expiration of the 12-month period described in paragraph (a) of this rule if the firm fails to make any submission pursuant to paragraph (a); or

(2) Upon the expiration of the period in which the firm may seek Commission review of any board determination made under paragraph (b) of this rule, if the firm does not seek Commission review of the Board determination; or

(3) Unless otherwise directed by Commission order or rule, 30 days after the firm formally requests Commission review pursuant to Section 104(h)(1)(B) of the Act.

#### Rule 4010. Board Public Reports

Notwithstanding any provision of Rules 4007, 4008, and 4009, the Board may, at any time, publish such summaries, compilations, or other general reports concerning the procedures, findings, and results of its various inspections as the Board deems appropriate. Such reports may include discussion of criticisms of, or potential defects in, quality control systems of any firm or firms that were the subject of a Board inspection, *provided* that no such published report shall identify the firm or firms to which such criticisms relate, or at which such defects were found, unless that information has previously been made public in accordance with Rule 4009, by the firm or firms involved, or by other lawful means.

## II. Board's Statement of the Purpose of, and Statutory Basis for, the Proposed Rules

In its filing with the Commission, the Board included statements concerning the purpose of, and basis for, the proposed rules and discussed any comments it received on the proposed rules. The text of these statements may be examined at the places specified in Item IV below. The Board has prepared summaries, set forth in sections A, B and C below, of the most significant aspects of such statements.

### A. Board's Statement of the Purpose of, and Statutory Basis for, the Proposed Rules

#### (a) Purpose

Section 104 of the Act requires the Board to conduct a continuing program of inspections to assess the degree of compliance of each registered public accounting firm and associated persons of that firm with the Act, the rules of the Board, the rules of the Commission, or professional standards, in connection with its performance of audits, issuance of audit reports, and related matters involving issuers. The Board has adopted Rules 4000 through 4010, and related definitions, to provide a procedural framework for the Board's

inspection program. Each of the rules and definitions is discussed below.

#### Rule 1001—Definitions of Terms Employed in Rules

*Appropriate State Regulatory Authority*—As discussed in more detail below, the Board has decided to add a definition of the term "appropriate state regulatory authority." The definition of that term in Rule 1001(a)(xi) is identical to the definition of the same term in Section 2(a)(1) of the Act.

*Professional Standards*—The definition of professional standards in Rule 1001(p)(vi) references that in Section 2(a)(10) of the Act. It should be noted that the term "professional standards" is broader than "auditing and related professional practice standards," which is defined in Rule 1001(a)(viii) of the Board's rules.

#### Rule 4000—General

Consistent with Section 104(a) of the Act, Rule 4000 subjects every registered public accounting firm to all such regular and special inspections as the Board may from time-to-time conduct in order to assess the degree of compliance of each registered public accounting firm and associated persons of that firm with the Act, the Board's rules, the rules of the Commission, and professional standards, in connection with its performance of audits, issuance of audit reports, and related matters involving issuers. The rule provides that inspection steps and procedures will be performed by the staff of the Division of Registration and Inspections and by such other persons authorized by the Board. The Board anticipates that "other persons authorized by the Board" to perform an inspection will include consultants and staff of the Board, other than staff of the Board's Division of Registration and Inspections.<sup>1</sup> The Board does not anticipate that practicing accountants associated with public accounting firms will participate in the Board's inspections.

#### Rule 4001—Regular Inspections

Rule 4001 requires that in performing a regular inspection, the staff of the

<sup>1</sup> The Board anticipates using some consultants to supplement its permanent staff on certain inspections during its first cycle of inspections. All inspections will be led by a senior staff member of the PCAOB's Division of Registration and Inspections. Once the first cycle of inspections is complete and the Board has further added to its inspections staff, the Board anticipates that consultants will be primarily used as technical specialists, as needed, on discrete issues in the course of inspections. Non-staff that participate in the Board's inspections will be subject to relevant provisions of the Board's Ethics Code, including the same confidentiality requirements to which the Board's inspection staff is subject.

Division of Registration and Inspections and other authorized persons take such steps and perform such procedures as the Board determines are necessary or appropriate. The rule requires the inclusion of steps and procedures set forth in Sections 104(d)(1) and (2) of the Act and such other tests of the audit, supervisory, and quality control procedures of the firm as the Director of the Division of Registration and Inspections or the Board determines.

Section 104(d)(1) requires the Board to "inspect and review engagements of the firm (which may include audit engagements that are the subject of ongoing litigation or other controversy between the firm and one or more third parties), performed at various offices and by various associated persons of the firm, as selected by the Board." Section 104(d)(2) requires the Board to "evaluate the sufficiency of the quality control system of the firm, and the manner of documentation and communication of that system by the firm."

#### Rule 4002—Special Inspections

Rule 4002 requires that in performing a special inspection, the staff of the Division of Registration and Inspections and other authorized persons take such steps and perform such procedures, as are necessary or appropriate concerning the issue or issues specified by the Board in connection with its authorization of the special inspection. A note to the rule makes clear that under Section 104(b)(2) of the Act, the Board may authorize a special inspection on its own initiative or at the request of the Commission. Like any other Board action, the vote of a majority of the Board members present at a meeting at which a quorum of Board members is present is required to authorize a special inspection.

In order to retain flexibility and to avoid a formulaic approach to such inspections, the Board has decided not to develop a set threshold or list of criteria that may lead to the commencement of a special inspection. For example, while the Board will consider the source of information it receives, the Board may find that in certain circumstances anonymous tips or media stories may be sufficient to begin a special inspection. Similarly, in order to retain flexibility, the Board has decided not to include a specific notice provision in the rule. As a practical matter, however, the Board's staff intends to give firms subject to special inspections reasonable notice in advance of commencing such inspections.

Special inspections are not intended to serve the same function as a Board

investigation, which will be conducted pursuant to the Board's investigative rules and procedures. Special inspections are designed to address issues that come to the Board's attention and, as a general matter, will be performed in order to assess the degree of compliance of each registered public accounting firm and associated persons of that firm with the Act, the Board's rules, the rules of the Commission, and professional standards, in connection with its performance of audits, issuance of audit reports, and related matters involving issuers. Nevertheless, any inspection—whether a regular inspection or a special inspection—may result in a particular matter being turned over to the Board's enforcement staff for investigation.

#### Rule 4003—Frequency of Inspections

Rule 4003 sets forth the schedule for regular inspections. Rule 4003(a) is consistent with the schedule for larger registered public accounting firms set forth in Section 104(b)(1)(A) of the Act. This rule requires that beginning no later than the year after its registration with the Board has been approved, a registered public accounting firm that, during the prior calendar year, issued audit reports with respect to more than 100 issuers will be subject to a regular inspection. Rule 4003(b) is consistent with the schedule for smaller registered public accounting firms set forth in Section 104(b)(1)(B) of the Act. Rule 4003(b) requires that beginning with the three-year period following the calendar year in which its registration with the Board has been approved, a registered public accounting firm that, during any of the three prior calendar years, issued audit reports with respect to at least one, but no more than 100, issuers, or that played a substantial role in the preparation or furnishing of an audit report with respect to at least one issuer, will be subject to a regular inspection.

In accordance with Section 104(b)(2) of the Act, the Board has added Rule 4003(c) which adjusts the regular inspection schedule for a registered public accounting firm that has requested to withdraw from registration by filing a completed Form 1-WD. Specifically, the rule provides that the Board shall have discretion not to conduct a regular inspection that would otherwise commence during the period beginning on the fifth day following the filing of the completed Form 1-WD and continuing until the firm's registration is deemed withdrawn or the firm withdraws its Form 1-WD.

The Board understands that firms that register with the Board will also have practices relating to audits other than

public company audits, and that state regulatory requirements continue to involve a peer review process related to those practices. The Board expects its inspections staff to make any appropriate recommendations concerning coordination with such reviews as the staff gains experience with issues relating to the implementation of the Board's inspection responsibilities.

#### Rule 4004—Procedure Regarding Possible Violations

Consistent with Section 104(c) of the Act, Rule 4004 sets forth procedures which the Board is required to follow with respect to possible violations by firms under inspection. Specifically, the rule requires that if the Board determines that information obtained by the Board's staff during any inspection indicates that the registered public accounting firm subject to such inspection, any associated person thereof, or any other person, may have engaged, or may be engaged in any act, practice, or omission to act that is or may be in violation of the Act, the rules of the Board, any statute or rule administered by the Commission, the firm's own quality control policies, or any professional standard, then the Board shall, if it determines it appropriate, report such possible violations to the Commission and each appropriate state regulatory authority. In addition, under Rule 4004, if the Board determines it appropriate, the Board shall commence an investigation of such act, practice, or omission in accordance with Section 105(b) of the Act and the Board's rules thereunder or commence a disciplinary proceeding in accordance with Section 105(c) of the Act and the Board's rules thereunder.

The phrase "if it determines appropriate" in Rule 4004 is meant to signal that the Board will decide which of these acts, practices and omissions would be appropriate to refer to the Commission and to the states or other authorities. In making this determination, depending on the nature of the possible violation, the Board could conclude that it may be appropriate to report information to the Commission, and not the states or other authorities, and vice versa.

A note to the rule makes clear that the Board may, as appropriate, report information and make referrals to agencies other than those specifically described in Rule 4004. The Note is intended to provide notice that Rule 4004, in implementing Section 104(c) of the Act, should not be understood as precluding the Board from exercising the Board's other statutory authority to

make referrals or to report information from inspections. Neither the rule nor the note are intended to describe the limit of that authority.

#### Rule 4005—Record Retention and Availability

Section 104(e) of the Act provides that the "rules of the Board may require the retention by registered public accounting firms for inspection purposes of records whose retention is not otherwise required by Section 103 or the rules issued thereunder." The Board is reserving this rule in anticipation of issuing standards on record retention once it has experience with its inspection program.<sup>2</sup> The Board reminds registered public accounting firms that they should continue to comply with all other applicable federal, state and professional record retention requirements.

#### Rule 4006—Duty To Cooperate With Inspectors

Rule 4006 requires every registered public accounting firm and every associated person of such firm to cooperate with the Board in any Board inspection. The rule requires that such firms and persons must cooperate and comply with any request, made in furtherance of the Board's authority and responsibilities under the Act, for documents or information. Like Section 102(b)(3) of the Act, the rule describes the required cooperation in terms of cooperating and complying with any request "made in furtherance of the Board's authority and responsibilities under the Act."

Rule 4006 is intended to provide for Board access to documents and information to the full extent authorized by the Act. Among other things, that means that the scope of the rule is not limited to documents and information generated in the course of audits of issuers. Under Section 104(d) of the Act, Board inspections involve evaluations and testing of, among other things, a firm's quality control and supervisory procedures. Accordingly, the documents and information the Board is likely to request as part of its authority and responsibilities to inspect registered public accounting firms, and that therefore a firm must cooperate by providing access to, will involve more than documents and information generated in the course of audits of issuers.

<sup>2</sup> The Board anticipates that standards concerning record retention will continue to be codified in the standards sections of the Board's rules. Any future Rule 4005 on record retention and availability for inspections will supplement those standards.

The Act provides that, in general, “all documents and information prepared or received by or specifically for the Board, and deliberations of the Board and its employees and agents, in connection with an inspection under section 104 \* \* \* shall be confidential and privileged as an evidentiary matter (and shall not be subject to civil discovery or other legal process) in any proceeding in any Federal or State court or administrative agency \* \* \*.” Accordingly, documents and information received by the Board pursuant to Rule 4006 in connection with a Section 104 inspection are entitled to this statutory protection. In addition, as discussed in more detail in the Board’s release adopting its investigation and adjudication rules,<sup>3</sup> the Board intends to recognize certain privileges recognized elsewhere in the law—specifically, privileges that, under prevailing law, would constitute a valid basis for declining to comply with a Commission subpoena. As explained in more detail in that release, however, the Board will not honor assertions of an “accountant-client” privilege. More generally, any perceived state law or professional nondisclosure requirements or other obstacles to cooperation (other than a privilege that would be a valid basis for resisting a Commission subpoena) are, in the Board’s view, preempted by the Act. Accordingly, a failure to cooperate with a Board inspection on the basis of such requirements would be a violation of Rule 4006.

#### Rule 4007—Procedures Concerning Draft Inspection Reports

Rule 4007 describes procedures relating to a registered public accounting firm’s opportunity to review and comment on a draft inspection report before the Board issues a final inspection report concerning the firm. Rule 4007(a) provides that the Director of the Division of Registration and Inspections will make a draft report available for review by the firm that is the subject of the report. Paragraph (a) provides that a firm then has 30 days, or such longer period as the Board may order, in which to submit any written response that the firm wishes to submit to the draft. A firm is not required to submit a response, and any response that a firm chooses to submit may include any comments, objections, recommended revisions, or other views on the draft report.

Rule 4007(b) concerns requests that a firm may make for confidential

treatment of portions of its response to the draft. Rule 4007(b)(1) provides that a firm may request confidential treatment under Section 104(f) of the Act for any portion of the firm’s response to the draft report and may supply any supporting authority or other justification for according confidential treatment to the specified information. Rule 4007(b)(2) implements Section 104(f)’s requirement that the Board shall attach to, and make part of, the inspection report, any response submitted by the firm. Further implementing Section 104(f), Rule 4007(b)(2) provides that the version of the response that becomes part of the inspection report will be redacted to exclude any information for which the firm requested confidential treatment and which it is reasonable to characterize as confidential.

The Section 105(b)(5)(A) confidentiality protection extends to documents “received by” the Board and to documents “prepared \* \* \* specifically for” the Board. The response that a firm provides to the Board falls into both of those categories. The Board will therefore maintain the response as confidential except to the extent that the Act expressly allows or requires the Board to disclose it.

The Act expressly allows or requires the Board to disclose the firm’s response in at least three ways. First, Section 104(f) of the Act requires that the text of the firm’s response must be attached to and made part of the inspection report. As part of the inspection report, the response will become public if and when the relevant portion of the report becomes public. Second, Section 104(g)(1) of the Act requires that the Board transmit the firm’s response to the Commission and to appropriate state regulatory authorities when the Board transmits the final report to them. Third, Section 105(b)(5)(B) allows the Board to transmit to the regulatory and law enforcement agencies specified there any materials covered by Section 105(b)(5)(A), which would include the firm’s response to the draft.

Any confidential treatment that the Board grants pursuant to a firm’s request under Section 104(f) would restrict disclosure of the information only in the context of the first of those three possibilities—the inclusion of the response as part of the inspection report. The only consequence of the confidential treatment afforded under Section 104(f) is that the Board will redact the confidential information from the version of the response that is attached to and made part of the inspection report. Accordingly, if the portion of the final report that includes

the response eventually becomes public, it will not include any information granted confidential treatment under Section 104(f).<sup>4</sup> In the second and third contexts described in the preceding paragraph, however, nothing in Section 104(f) operates to limit what the Board may disclose to certain regulatory and law enforcement agencies.

Rule 4007(c) provides that after receiving the firm’s response, the Board has various options. The rule permits the Board to take such action with respect to the draft report as it considers appropriate. For example, the Board may adopt the draft report as the final report, revise the draft report, or continue or supplement the inspection before issuing a final report. If the Board directs the staff to continue or supplement the inspection or revise the draft report, the Board may, in its discretion, afford the firm the opportunity to review any revised draft inspection report. Rule 4007(c) permits the Board, in its discretion, to afford firms a second opportunity to comment on an inspection report when the Board continues or supplements its inspection or revises a draft report after receiving a firm response. The Board intends to afford registered firms an opportunity to comment on revised reports when new findings or assessments have been made or, more generally, when significant changes have been made to the draft report by the Board.

#### Rule 4008—Procedures Concerning Final Inspection Reports

Rule 4008 describes procedures related to a final inspection report. Rule 4008(a) provides that the Board will make a final inspection report available for review by the firm that is the subject of the report. As is true of draft inspection reports under Rule 4007, Rule 4008 requires that the Board make the final report available for the firm’s review, but the Board need not necessarily allow the firm to have and maintain its own copy of the full report. Rule 4008(b) provides that the Board will transmit the final report to the Commission, along with any additional letter or comments by the Board or the Board’s inspectors and along with the

<sup>4</sup> For example, if the firm’s response is directed to the portion of the report that deals with quality control defects, the response will not be made public for as long as that portion of the report is not made public. That portion of the report may be made public, however, if the firm fails to address the criticisms to the Board’s satisfaction within 12 months. At that time, that portion of the report, including the firm’s response, would be made public, but any part of the response that had received confidential treatment under Section 104(f) would be redacted from the report that is made public.

<sup>3</sup> PCAOB Release No. 2003–016, at pages A2–33—A2–34 (Sept. 29, 2003).

firm's response to any draft of the report. Rule 4008(c) provides that the Board will transmit to each appropriate state regulatory authority, in appropriate detail, the final report, any additional letter or comments by the Board or inspectors, and the firm's response to any draft of the report. The Act leaves to the Board's discretion the determination of what detail is or is not appropriate for reporting to a state regulator. The rule allows the Board the flexibility to exercise that discretion.

Section 104(g)(1) of the Act requires that the Board transmit the final report "in appropriate detail, to the Commission and each appropriate State regulatory authority, accompanied by any letter or comments by the Board or the inspector, and any letter of response from the registered public accounting firm." Rules 4008(b) and 4008(c) implement that provision of the Act.

A final inspection report is a document prepared by the Board in connection with an inspection, and would therefore generally be covered by Section 105(b)(5)(A)'s confidentiality protection. A final inspection report is also likely to contain substantial information "received by" the Board in connection with an inspection, and that is independently subject to the protection of 105(b)(5)(A), as the Act explicitly notes in Section 104(g)(2).<sup>5</sup> A final inspection report is also unique, however, in that the Act separately contemplates, in Section 104(g)(2), that at least some portions of it will be publicly available.

The Act plainly does not require that a state regulator maintain the confidentiality of any portion of a final report that becomes publicly available pursuant to Section 104(g)(2). Any other portion of the final report, however, as well as any letter that accompanies the transmittal and any copy of the firm's response to a draft report, are subject to the protection of Section 105(b)(5)(A) and, as a consequence, a state regulator receives them subject to Section 105(b)(5)(B)'s express requirement to maintain them as confidential and privileged. Moreover, with respect to portions of the final report that address quality control defects, state regulatory authorities are equally bound by Section 104(g)(2)'s command that such portions of the report shall not be made public unless the firm fails to do certain things within 12 months of the report's issuance.<sup>6</sup> Any otherwise applicable

state or local law that conflicts with this requirement or stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress would be preempted.<sup>7</sup>

#### Rule 4009—Firm Response to Quality Control Defects

Consistent with Section 104(g)(2) of the Act, when a final inspection report contains any discussion of criticisms of, or potential defects in, the firm's quality control systems, Rule 4009(a) permits the firm to submit evidence or otherwise to demonstrate to the Director of the Division of Registration and Inspections that it has improved such quality control systems, and remedied such defects. This submission or demonstration must be made no later than 12 months after the issuance of the Board's final inspection report. The date of issuance will be the date the final inspection report is adopted by the Board as final. Absent extraordinary circumstances, the report will be available for review by the firm beginning on that date. The rule requires the Director, after reviewing the evidence, to advise the firm whether he or she will recommend to the Board that the firm has satisfactorily addressed the criticisms or defects in the quality control system of the firm identified in the final inspection report and, if not, why not.

Rule 4009(b) provides that if the Board determines that the firm has satisfactorily addressed all quality control defects and criticisms in the final report, the Board will promptly provide notice of that determination to the Commission and to any appropriate state regulatory authority to which the Board had provided any portion of the final inspection report.

Rule 4009(c) requires the Board to notify the firm of its final determination as to whether the firm has addressed to the satisfaction of the Board the criticisms or defects in the firm's quality control system.

Rule 4009(d) provides that the Board will make public those portions of a final inspection report dealing with such criticisms and defects if the firm fails to address those matters to the Board's satisfaction within 12 months of the issuance of the final inspection report. Rule 4009(d) specifically addresses the time of any such public disclosure. Under Rule 4009(d), if a firm made no submission to the Board under Rule 4009(a) concerning the firm's efforts to address the criticisms or

potential defects, then the Board would make those portions of the report public upon the expiration of the 12-month period. If the firm made a submission under Rule 4009(a), but then failed to seek Commission review of an adverse Board determination concerning that submission within the time allowed to seek such review, the Board would make those portions of the report public upon the expiration of the period allowed for seeking Commission review. If the firm did timely seek Commission review, under Section 104(h)(1)(B) of the Act, of an adverse Board determination, the Board would make those portions of the report public 30 days after the firm formally requested Commission review, unless the Commission, by rule or order, directs otherwise. The Board is adopting a 30-day delay, subject to any superseding Commission rule or order, to allow the Commission an opportunity to consider whether to order a longer stay of public disclosure in a particular case, since the Act does not operate to stay such disclosure.

#### Rule 4010—Board Public Reports

Rule 4010 permits the Board, at any time, to publish public summaries, compilations, or other general reports concerning the procedures, findings, and results of its various inspections as the Board deems appropriate. The rule allows for these reports to include discussion of criticisms of, or potential defects in, quality control systems of any firm or firms that were the subject of a Board inspection. However, the rule prohibits these published reports from identifying the firm or firms to which these criticisms relate, or at which the defects were found, unless the information has previously been made public pursuant to the Board's rules or other lawful means. The phrase "other lawful means" refers to situations in which the covered information is made public by lawful means provided for in the Act.

##### (b) Statutory Basis

The statutory basis for the proposed rules is Title I of the Act.

##### *B. Board's Statement on Burden on Competition*

The Board does not believe that the proposed rules will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. The proposed rules provide a procedural framework for the program of continuing inspections that the Act requires the Board to conduct. With respect to the firms to be inspected, the proposed rules impose no

<sup>5</sup> See Section 104(g)(2) (noting that disclosure of reports to public is "subject to section 105(b)(5)(A)").

<sup>6</sup> The Act does not prohibit a firm from voluntarily disclosing or providing a report or any portion of a report to any person.

<sup>7</sup> See *Crosby v. National Foreign Trade Council*, 530 U.S. 363, 372–73 (2000); *City of New York v. FCC*, 486 U.S. 57, 64 (1988).

burden beyond the burdens clearly imposed and contemplated by the Act.

*C. Board's Statement on Comments on the Proposed Rules Received From Members, Participants or Others*

The Board released the proposed rules for public comment in PCAOB Release No. 2003-013 (July 28, 2003). A copy of PCAOB Release No. 2003-013 and the comment letters received in response to the PCAOB's request for comment are available on the PCAOB's web site at [www.pcaobus.org](http://www.pcaobus.org). The Board received 16 written comments. The Board has clarified and modified certain aspects of the proposed rules in response to comments it received, as discussed below.

To address one commenter's concern about the scope of the Board's inspections, the Board clarified in the rule that registered public accounting firms will be subject to regular and special inspections "in order to assess the degree of compliance of each registered public accounting firm and associated persons of that firm with the Act, the Board's rules, the rules of the Commission, and professional standards, in connection with its performance of audits, issuance of audit reports, and related matters involving issuers."

One commenter was confused by, and asked the Board to explain, the provisions of the proposed rule that stated that, at the conclusion of each inspection, the Director would submit a draft report to the Board and then, unless the Board directed that transmittal be deferred, transmit the draft report to the firm under review. This part of the rule only described internal Board procedures. To eliminate any confusion created by this provision and to preserve the Board's flexibility to structure its internal processes, the Board deleted these provisions from the rule.

The Board also made a change concerning the amount of time within which the rule requires a firm to submit a response to a draft inspection report. Commenters suggested that the proposed period, 30 days, was too short. The Board believes that, as a general matter, 30 days allows sufficient time, but the Board added a provision that would allow the Board to grant a longer period when warranted by unusual circumstances.

One commenter suggested that the rules should more closely track the Act by expressly providing that a firm's response to a draft inspection report would be attached to, and made part of, any final report. The Board incorporated such a provision in the final rules.

One commenter noted that the Board's description of the state authorities that would receive the final inspection report under Rule 4008, as proposed, differed slightly from the authorities described in the Act's definition of "appropriate state regulatory authority." In response to this comment, the Board changed its rule to more closely track the Act. Specifically, the Board added a definition of "appropriate state regulatory authority" based on the definition of that term in the Act. The Board expects that, in most cases, the appropriate state regulatory authority to receive an inspection report will be any state, agency, board or other authority that has issued a license or certification number authorizing the firm to engage in the business of auditing or accounting.

Finally, one commenter suggested that the Board notify the Commission and each appropriate state regulatory authority to which the final inspection report was provided under Rule 4008(b) and (c) of the Board's final determination concerning whether the firm has addressed the criticisms or defects in the quality control system of the firm identified in the inspection report to the satisfaction of the Board. The Board implemented this suggestion by adding paragraph (b) to Rule 4009. Rule 4009(b) provides that if the Board determines that the firm has satisfactorily addressed all quality control defects and criticisms in the final report, the Board will promptly provide notice of that determination to the Commission and to any appropriate state regulatory authority to which the Board had provided any portion of the final inspection report.

### III. Date of Effectiveness of the Proposed Rules and Timing for Commission Action

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding, or (ii) as to which the Board consents, the Commission will:

(A) By order approve such proposed rules; or

(B) Institute proceedings to determine whether the proposed rules should be disapproved.

### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule is

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

*Electronic comments:*

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/pcaob.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number PCAOB-2003-08 on the subject line.

*Paper comments:*

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. All submissions should refer to File Number PCAOB-2003-08. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/pcaob.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Section, 450 Fifth Street, NW., Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of PCAOB. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number PCAOB-2003-08 and should be submitted on or before May 14, 2004.

By the Commission.

**Jill M. Peterson,**

*Assistant Secretary.*

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