



U.S. Securities and Exchange Commission

Speech by SEC Staff: "Considering Audit Regulation under SOX"

by

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Introduction

I'm delighted to be with you this morning to help kick-off the AICPA's 2007 National Conference on Current SEC and PCAOB Developments, of which there are many.

One of our major initiatives in the Professional Practice Group this year has been to improve the implementation of SOX Section 404. The Group had the lead in developing the new Interpretive Guidance for Management in conducting its required evaluation of internal control over financial reporting (or ICFR) under SOX Section 404(a), which was approved by the Commission in May. With this action, management can now look to SEC guidance, rather than the auditing literature, for conducting its evaluation of ICFR.

Much of the discussion of the interpretive guidance for management, as well as the PCAOB's new audit standard (AS 5), which was approved by the Commission in July, has revolved around improving efficiency. And both sets of guidance surely do allow management and auditors to take stock of their respective 404 efforts and eliminate costs that contribute little to improving the reliability of financial reporting. Nonetheless, it's important to emphasize that *improving effectiveness* was our overarching focus as we developed management guidance, and as we worked with the PCAOB as they developed

AS 5. And this afternoon, Josh Jones will be discussing with you some illustrations of how our management guidance facilitates better evaluations of ICFR.

On other fronts, the Professional Practice Group has a significant role in leading and coordinating the Commission's work with respect to auditor independence. This afternoon, Vassilios Karapanos will be discussing some of our work and selected independence issues that should be of interest to you.

Importantly, as Vassilios and Josh will note, we now have two "plain-English" brochures — one on auditor independence and another on management guidance — to help your clients understand and address the issues in each of these areas.

Looking to the future, Conrad, Jim, and Julie's talks mention some of the important initiatives in which OCA is involved, including one to improve financial reporting (and address complexity) (CIFIR), another to improve financial reporting in a global marketplace (IFRS), and a third to transform disclosure through the use of interactive data (XBRL). You will be learning more about each of these over the next few days, and how they will touch your lives.

Treasury Department Advisory Committee

But there is another important initiative underway — focusing specifically on auditing — by the Treasury Department's Advisory Committee on the Auditing Profession. The issues being addressed by this Committee are naturally of great interest to us, too — and OCA participates as an official observer on this Committee.

The Treasury's Advisory Committee is chartered to develop recommendations as to what can best be done to sustain a vibrant auditing profession. The Committee is co-chaired by Arthur Levitt (former SEC Chairman) and Don Nicolaisen (former SEC Chief Accountant). The Advisory Committee members represent a broad range of perspectives, including investors, auditors, large and small public companies, companies that insure auditors, lawyers, educators, and regulators.

The Committee has formed three subcommittees to address (1) human capital and its impact on audit quality; (2) the audit firm and the audit including: audit firm organization (i.e., structure, governance, and transparency), financial resources (including insurability and liability), and communication; and (3) structural issues in the auditing profession including competition, concentration, independence, and other professional standards. It is expected that the Committee will produce findings and recommendations by early summer of 2008.

The work of this Advisory Committee seems particularly timely. SOX turned five this year. Although you personally may not have taken much notice of this anniversary, five years does represent an appropriate milestone for

taking stock.

It is widely recognized that regulatory and market changes since SOX have significantly affected both the audit environment and the audit process. So now does seem to be an ideal time for stepping back to identify and confront the major issues we face for maintaining and improving the value and effectiveness of audits in the future.

SEC Oversight of the PCAOB

SOX established a new regulatory regime for auditors of public companies — namely the PCAOB. While most of you are acquainted with the work of the PCAOB, you may know less about the SEC's oversight of the PCAOB as required by SOX. So I would like to spend my remaining time providing a few insights on the SEC's role, in order to give you a more robust picture of the current regulatory landscape — for considering what's working well and what might need improvement — as you follow the activities of the Treasury's Advisory Committee and the SEC's initiatives, including CIFIR.

OCA has a significant role in leading and coordinating the Commission's activities in carrying out its responsibilities for oversight of the PCAOB under SOX. But, I must emphasize that the work is shared across many of the offices and divisions within the Commission.

Appointment of Board Members

First, let's consider the appointment of board members. SOX Section 101(e) gives the Commission, in consultation with the Board of Governors of the Federal Reserve System and the Secretary of the Treasury, responsibilities for appointment of PCAOB board members. The Commission has established a process for doing so. The Commission will be addressing the appointment of a new PCAOB Board member to replace Kayla Gillan who has announced that she will be leaving the Board.

PCAOB Budget and Strategic Plan

Another important oversight role for the Commission concerns the PCAOB's budget. SOX requires the Commission to review and approve the PCAOB's annual budget, and once again the Commission has established a process for doing so.

SOX Section 109 requires the PCAOB to establish a budget for each fiscal year, which is reviewed and approved by the Board not less than one month prior to the commencement of the fiscal year to which the budget pertains (actually by November 30th). The PCAOB Board approved their 2008 budget at an open meeting on November 19th, and the Commission plans to consider it at an Open Commission meeting tomorrow.

An integral part of the PCAOB's budget process, and important to the

Commission in fulfilling its oversight responsibilities, is the PCAOB's long-range strategic planning. In May of this year, the PCAOB approved its initial strategic plan, and this plan is posted on the PCAOB's website. We understand the PCAOB will be revising and updating this plan each year as part of its budget process, and the Commission is looking forward to working with the PCAOB in the coming months as it does so.

Examination of PCAOB Programs and Operations

Next, the Commission has the authority to conduct periodic, special, and other examinations of the records of the Board. OCA works with the SEC's Office of Compliance, Inspections, and Examinations (OCIE) in conducting such inspections. While the results of these inspections are shared with the PCAOB, they are not publicly available.

As one illustration of this oversight activity, the Commission has disclosed that an inspection this year is addressing the PCAOB's program for inspecting registered accounting firms. As part of this "inspection of inspections," the SEC staff is focusing on the PCAOB's compliance with the relevant provisions of SOX and the PCAOB's own rules and procedures, as well as considering the overall efficacy of the inspection process in carrying out the PCAOB's mission.

PCAOB Rules and Professional Standards

The Commission is required to approve all PCAOB rules and professional standards in order for them to become effective. So once rules or standards are adopted by the Board, the PCAOB files them with the Commission. The Commission then generally publishes the proposed rule or standard in the Federal Register for public comment. After considering comments, the Commission votes on whether to approve the rule or standard. If approved, the text of the Commission order is printed in the Federal Register and the rule or standard becomes effective in accordance with its terms. Once approved by the Commission, PCAOB rules also become enforceable by the Commission.

To facilitate the Commission's oversight responsibilities in this area, the staff meets regularly with the PCAOB staff to discuss and provide input on the PCAOB's standard-setting activities. In this regard, it is also noteworthy that in considering proposed PCAOB standards, a current priority for the Chief Accountant and OCA is how PCAOB standards relate to those of the IAASB and the ASB, where agreements exist for converging the latter two sets of standards.

Working towards convergence of auditing standards globally is likewise a theme that has emerged from discussions at the PCAOB's Standing Advisory Group meetings. Further, it is a perspective receiving prominence in the recommendations of other groups. For example, the Bloomberg/Schumer Report suggested that, "The PCAOB should take a world leadership role in establishing [the standardization of world-wide auditing standards] as a priority for the relevant national bodies." And, the GAO noted at the

Commission's April 4, 2007 open meeting, that "Everyone will be best served by having standard setters develop consistent core auditing standards."

On this note, and in the interest of time, let me conclude, even though Board appointments, the budget and strategic planning, inspections and examinations, and professional standards represent only a few of the areas that involve the Commission's oversight responsibilities with respect to the PCAOB. For those of you who would like to learn more about the SEC's role in these, as well as other areas, I recommend Brian Croteau's talk at the 2005 Conference, which is posted on the SEC's website.

Although brief, I hope these remarks give you a greater appreciation for the intricacies of the current regulatory structure, and will inform your thinking, as you follow the deliberations, and consider the recommendations, of the Treasury's Advisory Committee on the Auditing Profession and the SEC's CIFIIR Committee.

As I previously mentioned, the SEC, as one regulator of auditors and audit services is very interested in the work of these advisory committees. The mission of the SEC is to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation. The Federal securities laws recognize financial reporting, with full and fair disclosure, as a critical component in this mission. And, importantly, these laws recognize that having such reports — audited by knowledgeable, objective, independent accountants — is a bedrock principle that enhances the credibility and reliability of the financial information issuers provide to our markets.

We in OCA look forward to the results of the various initiatives that you will be hearing more about this week. These initiatives will be setting the stage for how we all will be moving forward over the next few years in the post-SOX environment, as we each carry out our respective, and important roles in our markets.

In this regard, Chairman Cox noted in a recent speech that, "As regulators, we have to be aggressive in our role as market referees and protectors of investors' interests. And at the same time we have to be humble in recognizing that regulation is not the fuel that drives our markets — though it undoubtedly is the oil that greases the gears." We recognize the importance of regulatory balance for economic vitality.

Thank you very much.

<http://www.sec.gov/news/speech/2007/spch121007zvp.htm>