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**Statement of the Shadow Financial Regulatory Committee**

on

**Sunset the PCAOB**

February 14, 2005

A centerpiece of the Sarbanes-Oxley Act of 2002, enacted in response to various accounting scandals that preceded it, was the creation of the Public Company Accounting Oversight Board ("PCAOB"). Congress charged the PCAOB with registering all accounting firms that audit public companies; developing new audit standards; inspecting audit firms to ensure that they meet these standards; and punishing firms that do not comply.

The PCAOB is private, non-for-profit company registered to do business in the District of Columbia. It has five members, including a Chairman, who are appointed by the Securities and Exchange Commission (SEC). The SEC also must approve the PCAOB's budget, which in 2004 was \$103 million. In that year, the organization had an average of 200 employees, indicating expenditures of approximately \$500,000 per employee. The PCAOB asked for \$153 million for 2005, but that amount was cut back by the SEC staff to \$136 million. The SEC has not yet formally approved this figure. Nonetheless, with a budget of \$136 million, the PCAOB would spend more than twice as much per employee as the National Association of Securities Dealers, which oversees securities brokers. In addition, the \$136 million budget implies an average of \$17 million for monitoring each of the eight accounting firms with more than 100 public company clients that the PCAOB must inspect every year.

In a highly unusual move, Congress gave the PCAOB the ability to fund its expenses by imposing a fee on all public companies, which is calculated in proportion to their market capitalizations. The Committee is unaware of any other private company that has been authorized to tax sectors of the economy it does not regulate.

Shortly before Sarbanes-Oxley was enacted, the Shadow Committee questioned the value of creating a new body like the PCAOB (Statement No. 176, February 25, 2002). The Committee noted that the SEC already had the authority to oversee and discipline auditors who attest to the statements issued by public companies.

Nothing that has happened in the three years since Sarbanes-Oxley was enacted to change the Committee's views. To the contrary, the rapid growth of the PCAOB's budget and employment levels should give policy makers reason to question whether the organization should continue in its present form.

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The Committee believes that the PCAOB's basic functions ultimately should be transferred to the SEC. The SEC is perfectly capable of handling the PCAOB's current functions of registering audit firms and overseeing their compliance with audit standards. Accordingly, Congress should give the SEC the authority to carry out these activities now. To the extent that the Commission requires additional resources – above its current budget – to discharge these duties, the agency should ask Congress for them through the normal appropriations process. If Congress believes that public companies should shoulder the burden of these registration and enforcement functions, it (and not the PCAOB) should set and collect those fees, allowing them to flow through the normal budget process for all regulatory agencies.

Meanwhile, the PCAOB currently is in the process of revising the auditing standards previously developed by the American Institute of Certified Public Accountants. While this is a major job, this revision should take no more than a few years. To ensure that this task is carried out promptly, the SEC should give the PCAOB a clear deadline to produce a set of standards, which the SEC must approve before they can take effect. Once an initial set of standards is endorsed, the SEC itself could assume the task of updating auditing standards through its office of the Chief Accountant. In addition, after the SEC sets a deadline, Congress should sunset the PCAOB.

Finally, Section 404 of Sarbanes-Oxley requires public companies to attest to the adequacy of their "internal controls," a procedure that the PCAOB oversees. Although we believe it is too early to know whether benefits of this particular part of the Act will be worth the costs, it is not necessary that the PCAOB be kept alive simply to ensure that public companies comply with this requirement. All oversight functions related to Section 404, as well as other requirements of Sarbanes-Oxley that are related to the accounting profession and disclosure by public companies, can and should also be transferred to the SEC.