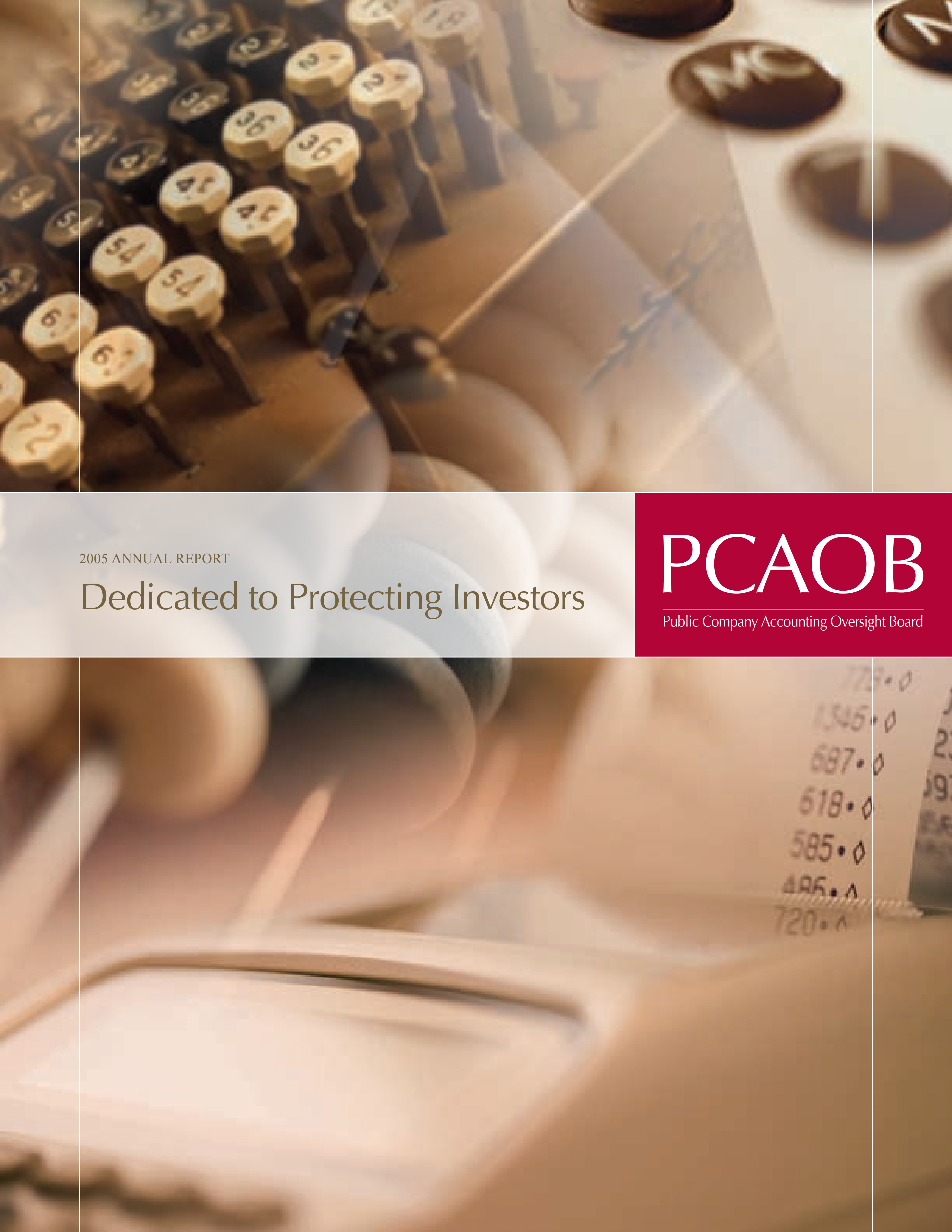


2005 ANNUAL REPORT

Dedicated to Protecting Investors

PCAOB

Public Company Accounting Oversight Board

PCAOB

Public Company Accounting Oversight Board

THE PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD IS A PRIVATE-SECTOR, NON-PROFIT CORPORATION, CREATED BY THE SARBANES-OXLEY ACT OF 2002, TO OVERSEE THE AUDITORS OF PUBLIC COMPANIES IN ORDER TO

PROTECT THE INTERESTS OF INVESTORS

AND FURTHER THE PUBLIC INTEREST IN THE PREPARATION OF INFORMATIVE, FAIR, AND INDEPENDENT AUDIT REPORTS.

From the Acting Chairman

I am pleased, on behalf of the Public Company Accounting Oversight Board, to submit the report on our activities in 2005. While the Sarbanes-Oxley Act of 2002 requires the PCAOB to submit an annual report to the Securities and Exchange Commission, this report is also a continuation of what has been a practice of outreach and dialogue for the PCAOB. We firmly believe that we must listen to and learn from the people and organizations that are affected directly and indirectly by our work.

Indeed, communication—both speaking and listening—has been the hallmark of the PCAOB from its beginning. As a founding member of the Board, I have been gratified by the consensus among the Board and its staff that our work on behalf of investors requires us to gather information, perform our responsibilities in a professional and forthright way, and to welcome feedback on our performance.

This commitment to openness is most apparent in the Board's rulemaking and standards-setting process. Any proposed rule or standard is made available publicly for comment. We always take public comments into account in finalizing our rules and standards.

The formal rule making process is not the only way in which the Board seeks input on rules and standards we are considering. We meet frequently with those most directly affected by our work—auditors, corporate leaders, and investors. These stakeholders are all represented on our Standing Advisory Group, which advises the Board on its standards-setting priorities. We also meet in other formal and informal settings with individuals and groups whose ideas can provide insight into how the Board can better carry out its responsibilities under the Act. In addition, we confer regularly with our fellow regulators on matters of mutual importance.

My colleagues and I have also taken the opportunity to speak on campuses around the country. This has enabled us to reach not only educators, but also the accountants and auditors of tomorrow. This is particularly gratifying to me, as I have a deep and longstanding interest in academia. I am especially interested in the work of many distinguished accounting professors who are pursuing research projects that I believe will inform the Board's future standards-setting.

Some of our most important communication does not involve lecterns or conference tables, but occurs face-to-face with the auditors we oversee, particularly in the inspection process.

PCAOB inspectors are on the front line with the registered accounting firms. PCAOB inspectors were engaged in ongoing dialogue with the firms throughout the inspections of 281 registered accounting firms in 2005. Much of this dialogue is aimed at working with auditors to improve audit quality before deficiencies in audit quality become a matter for discipline or, more importantly, investor loss. It is the Board's hope that this on-site dialogue will result in more effective and more efficient audits, which are clearly in the interest of investors.

During 2005, we continued our dialogue with non-U.S. regulators concerning the oversight of registered accounting firms based outside the United States, and we initiated our inspection program in selected non-U.S countries. Our goal continues to be reliance on home-country oversight depending on the degree of rigor and independence of the home-country systems.

To assist auditors, issuers, and investors, we communicate the findings of our inspections of registered accounting firms through publication on our Web site of the public portions of these reports. In addition, the Board may issue summary reports of our findings from inspections. We did this in 2005 in our initial assessment of how firms conducted their audits of internal control over financial reporting. We will release more such reports in 2006 because we believe they are a valuable tool for conveying broad issues and trends that we have identified.

Finally, I would be remiss if I failed to note that much of the dialogue in 2005 involved companies' internal control and auditors' duties related to that important safeguard for financial reporting. Significant Board resources were dedicated to providing guidance to auditors of public companies during 2005 as public companies, their investors, and others digested the new reporting requirements related to internal controls over financial reporting.

The Board and staff of the PCAOB take seriously the Board's mission as set forth in the Sarbanes-Oxley Act. This report conveys the steps that the Board and its staff have taken during 2005 to carry out this important mission.

Bill Gradison

Bill Gradison
Acting Chairman
Public Company Accounting Oversight Board
Washington, D.C.

May 2006

Overview

2005 marked the third year of operations of the Public Company Accounting Oversight Board. During 2005, the PCAOB continued to make progress in fulfilling its Congressional mandate to protect investors by overseeing the auditors of public companies through inspections, enforcement, and standards-setting.

Most of the PCAOB's resources in 2005 were dedicated to meeting its responsibility to inspect the quality of the audits performed by registered public accounting firms. In 2005, the Board began its first inspections of registered accounting firms that are based outside of the United States, and it began publishing reports on the first full inspections of U.S.-based accounting firms. The Board also took its first disciplinary actions against accounting firms and auditors.

The Board also addressed concerns about auditors' involvement with aggressive tax shelters by approving its first ethics and independence rules relating to auditors' provision of tax services to audit clients.

For many public companies and their auditors, 2005 was the first year of reporting to meet the requirements of the Sarbanes-Oxley Act regarding companies' internal control over financial reporting. The Board and PCAOB staff undertook a number of initiatives during the year related to the implementation of auditor reporting under these new requirements.

The Board's outreach efforts throughout 2005 involved dialogue with a wide range of interested groups about all PCAOB auditing standards, as well as inspections, ethics, international oversight, and enforcement.

The most targeted effort to obtain and share information on the Board's work involved a series of invitational meetings that began in late 2004 and were held in nine cities in 2005, the Forum on Auditing in the Small Business Environment. Conceived in response to concerns about the effects of the Sarbanes-Oxley Act and the Board's rules on small accounting firms and small public companies, the Forum is a program for the small business community to learn more about the work of the Board, especially the PCAOB inspections process and the impact of new auditing standards.

Invited participants are auditors from smaller registered public accounting firms and directors and financial executives of smaller public companies. Almost 1,000 people attended the forums in 2005, and the Board deemed the information it received to be so important that the program is scheduled to be held in eight cities in 2006.

The PCAOB also maintained its dialogue with other oversight organizations, including the Financial Accounting Standards Board, the National Association of State Boards of Accountancy, the Government Accountability Office, non-U.S. regulators, and, particularly, the Securities and Exchange Commission.

The Sarbanes-Oxley Act gives the SEC oversight authority over the Board, including the power to appoint and remove Board members. The SEC, among other things, must approve the Board's budget and rules, including auditing standards, and may review appeals of disciplinary actions against registered accounting firms and associated persons, as well as appeals of certain matters relating to Board inspections of registered accounting firms.

The SEC appoints Board members of the PCAOB after consultation with the Chairman of the Board of Governors of the Federal Reserve System and the Secretary of the Treasury. During most of 2005, the Board comprised Chairman William J. McDonough and Board members Kayla J. Gillan, Daniel L. Goelzer, Bill Gradison, and Charles D. Niemeier. On September 23, 2005, Chairman McDonough announced his intention to resign from the Board, effective November 30, 2005. On December 2, 2005, the SEC named Bill Gradison Acting Chairman.

Registration

The Sarbanes-Oxley Act of 2002 and the Board's rules prohibit accounting firms that are not registered with the Board from preparing or issuing audit reports on U.S. public companies or from playing a substantial role in these activities. Registered firms are subject to the Board's oversight, including its inspections and enforcement authority.

Accounting firms continued to seek registration with the Public Company Accounting Oversight Board throughout 2005. The Board approved 244 registration applications in 2005, bringing the total number of registered firms to 1,591 by year-end.

These firms have diverse characteristics, which have required the Board to tailor its oversight programs to the various types of firms that have registered. For example, 646 of the firms registered with the Board at the end of 2005 were based outside the United States, in 80 countries. In addition, 559 of the firms that were registered at the end of 2005 reported one to five issuer audit clients, and 801 firms registered at the end of 2005, including 378 in the United States, reported no issuer clients at the time they applied for registration.

Number of Issuers Per Registered Firms
(as of 12/31/05)

ISSUER CLIENTS	REGISTERED FIRMS
101 or more	9
51–100	8
26–50	26
11–25	81
6–10	107
1–5	559
0	801
TOTAL	1591

The Board issued orders disapproving the registration applications of 13 public accounting firms during 2005. A list of registered firms and the Board's findings regarding the firms whose registration applications were disapproved are available on the Board's Web site.

International Cooperation

The Sarbanes-Oxley Act requires oversight of all public accounting firms that prepare or issue any audit report on financial statements that are filed in the United States, regardless of where the accounting firms are located.

To perform these duties, early after its formation, the Board embarked on a dialogue with non-U.S. regulators concerning the oversight of accounting firms that audit public companies and the possible development of cooperative arrangements for such oversight.

The Board's oversight rules set forth a cooperative model under which the PCAOB may rely, if appropriate, on inspection or enforcement work performed by the home-country regulator. The degree of reliance on the home-country regulator is based on the independence and rigor of the home-country system of oversight. The more independent and rigorous the home-country system, the more the Board may rely on it. For inspections, the degree of reliance also depends on agreement between the PCAOB and the home-country regulator on the inspection work program for individual firms. The Board's oversight rules provide for the PCAOB to assist non-U.S. regulators on inspections and investigations of U.S. firms subject to dual oversight.

In order to begin implementing such a cooperative framework, the PCAOB has forged relationships over the course of the past two years with regulators in many countries. The PCAOB also has established a very productive working relationship with the European Commission.

Congress' approach to auditor oversight, as articulated in the Sarbanes-Oxley Act of 2002, is increasingly being shared by legislative bodies outside the United States. For example, in late 2005, the European Union finalized a new 8th Company Law Directive, which calls for each of the E.U. member states to establish external and independent auditor oversight systems that are transparent, well-funded, and "free from any possible undue influence by statutory auditors or audit firms." The Directive also provides for cooperation among regulators within the European Union and with non-E.U. regulators, such as the PCAOB.

In addition to working with its counterparts in the oversight of accounting firms, the Board supports efforts of non-U.S. regulators and professional bodies to develop high-quality professional standards for auditing. The PCAOB participates as an observer, with speaking rights, at meetings of the International Federation of Accountants' International Auditing and Assurance Standards Board (IAASB) and meets periodically with other national standards-setters. Similarly, the IAASB participates as an observer at meetings of the Board's Standing Advisory Group, in order that the Board may benefit from insights and best practices developed by regulators and auditors in other jurisdictions. In the same vein, other standards-setters sometimes look to the work of the PCAOB. For example, in 2005 the IAASB issued a revised International Standard on Auditing on audit documentation that was based substantially on the principles of the Board's Auditing Standard No. 3.

Number of Registered Firms By Country

(as of 12/31/05)

COUNTRY	NUMBER OF REGISTERED FIRMS
Canada	55
United Kingdom	52
China	48
Australia	34
France	29
India	27
Germany	25
Singapore	18
Brazil, Israel	16
Mexico	15
Spain	13
Belgium, Japan	12
Ireland, Taiwan	11
Italy, Netherlands, New Zealand, South Africa	10
Argentina, Republic of Korea, Russian Federation, Turkey	9
Malaysia	8
Switzerland, Thailand, Indonesia	7
Colombia, Norway, Philippines, Poland, Portugal, Sweden, Venezuela	6
Chile, Costa Rica, Czech Republic, Finland, Peru, Romania	5
Austria, Bermuda, Cayman Islands, Denmark, Greece, Hungary, Kazakhstan, Panama	4
Luxembourg, Pakistan	3
Bahrain, Bolivia, Egypt, Iceland, Malta, Slovakia, Slovenia, Ukraine	2
Bahamas, Belize, Brunei Darussalam, Bulgaria, Cambodia, Croatia, Cyprus, Dominican Republic, El Salvador, Estonia, Georgia, Ghana, Haiti, Lao People's Democratic Republic, Lebanon, Mauritius, Papua New Guinea, Paraguay, United Arab Emirates, Uruguay, Vietnam	1
TOTAL NON-U.S. FIRMS REGISTERED	646

Inspections

The Sarbanes-Oxley Act requires the Board to conduct annual inspections of the registered firms that audit more than 100 public companies. Under the Act, other firms that audit any public companies are required to be inspected at least once every three years. The Board also has the authority to conduct special inspections as is necessary or appropriate to address issues that come to the Board's attention.

In 2005, the PCAOB inspected 281 registered accounting firms. Of that number, nine firms audited more than 100 public companies: the eight largest U.S. accounting firms and one Canadian firm. The other firms inspected in 2005—257 U.S. firms and 15 non-U.S. firms—each audit 100 or fewer public companies.

The Board's inspection teams are composed of experienced accountants. In 2005, the leaders of the teams conducting large-firm inspections had an average of 23 years of relevant experience, and all other inspection team members averaged more than 14 years of relevant experience.

To facilitate the inspections of both the national and practice offices of the largest firms and the inspections of the widely dispersed smaller firms, the Board's inspection teams are located across the United States in PCAOB offices in Atlanta, Chicago, Dallas, Denver, New York City, Orange County, San Francisco, and Washington, D.C.

The PCAOB in 2005 conducted PCAOB office-based inspections of 56 smaller firms, which entailed the examination of the firms' audit work papers from within PCAOB offices, preserving PCAOB resources and minimizing disruption to the smaller firms. Based on this model, the Board expects to expand PCAOB office-based inspections in 2006.

In 2005, PCAOB inspectors reviewed portions of more than 365 audits performed by the largest nine firms and 623 audits performed by 272 smaller firms. The PCAOB chose those audits, and the particular aspects reviewed, on the basis of its assessment of the risk of material misstatements or significant auditing deficiencies, as well as firm-specific risks.

Board inspectors also often select additional audits during the course of the inspection, in order to follow leads to the root causes of poor auditing. For example, if PCAOB inspectors find a poor-quality audit that passed the muster of a firm's own internal quality control reviews, they may review additional work performed by the same audit partner and engagement team. PCAOB inspectors may also review other work performed by the internal reviewers who missed the reviewed partner's errors.

When PCAOB inspectors find potential material accounting errors or significant auditing deficiencies, they invite the auditing firm to comment on the accounting and auditing work involved. This assessment process not only helps to verify the Board's assessments, but it also helps the firm to identify the causes and scope of the problem.

Throughout this comment process, inspectors discuss the problems identified with representatives of the firm, including, as applicable, members of the engagement team, the representative responsible for the firm's handling of the inspection, national office experts, and ultimately, the managing partner or chief executive of the firm.

Serious problems are ultimately described in Board inspection reports, but even before reports are issued, inspectors' discussions with firms during the inspection often drive the firms to redress the problems on the spot, through performing missed auditing procedures, enhancing internal quality control requirements, discussing the problem with the client involved, and other actions.

Throughout 2005, the Board issued 173 reports on inspections conducted in 2004 and 2005. As provided in the Sarbanes-Oxley Act, the Board releases portions of its reports publicly. The public portion of a report summarizes any significant auditing deficiencies observed in the inspection. The public portions of the reports are posted on the Board's Web site.

Section 104(g)(2) of the Act provides that no portions of an inspection report that deal with criticisms of or potential defects in the quality control systems of a firm under inspection shall be made public if those criticisms or defects are addressed by the firm, to the satisfaction of the Board, not later than 12 months after the date of the inspection report. This reflects a legislative policy choice encouraging self-correction.

In addition, the Board takes a supervisory approach to oversight and seeks through constructive dialogue to encourage firms to improve their practices and procedures. Every Board inspection report that includes a quality control criticism alerts the firm to the opportunity to prevent the criticism from becoming public. The inspection report specifically encourages the firm to initiate a dialogue with the Board's inspections staff about how the firm intends to address the criticisms. The Board provides the opportunity for dialogue so that a firm acting in good faith can receive timely feedback from the staff and enhance its efforts accordingly before the 12-month deadline.

In addition to reports on inspections of individual firms, the Board's rules provide that the Board may publish summaries, compilations, or general reports concerning the results of its various inspections, provided that no such published report may identify the firm or firms to which any quality control criticisms in the report relate.

The Board issued such a report on November 30, 2005, discussing issues identified in the course of the Board's monitoring of the implementation of Auditing Standard No. 2, *An Audit of Internal Control Over Financial Reporting Performed in Conjunction with an Audit of Financial Statements.* That standard implements Sections 103 and 404 of the Sarbanes-Oxley Act by establishing a process for auditing a public company's internal control over financial reporting in conjunction with an audit of financial statements. The Board's report was based in significant part on information obtained by the Board in the Board's inspection process, which, in the 2005 cycle, included review of portions of a limited selection of audits of internal control.

Beginning in 2006, with experience and enhanced capacity, inspections of internal control audits will be integrated into the routine inspections with emphasis on the quality of the audits of financial statements and how well the firms have implemented the guidance provided by the PCAOB, focusing on the extent to which firms have gained efficiencies (the least expenditure of effort and resources) by implementing that guidance.

Research and Analysis

The PCAOB uses a risk-based approach to performing its oversight programs. For example, the PCAOB's inspections teams identify audits for review based on an evaluation of the risks of misstatements or omissions in financial reporting, and they further maximize the effectiveness of their review by selecting the portions of those audits that are likely to pose the most challenging audit issues.

To evaluate financial reporting risks, PCAOB programs use a risk model and other tools developed and maintained by the PCAOB's Office of Research and Analysis. This Office was formed in 2005 by combining the operations of the Office of Financial Analysis and Risk Assessment and the Risk Analysis group of the Division of Registration and Inspections. The Office uses its model, which makes use of data obtained in inspections and other programs, as well as publicly available information, to identify trends and developments in financial markets, business conditions or the activities of registered audit firms that may have significant effects on risk.

In addition to developing and maintaining risk analysis tools, the Office also evaluates the effects of PCAOB activities, such as new auditing standards, in order to improve the effectiveness and efficiency of public company auditing.

Auditing Standards

The Board and staff of the PCAOB devoted considerable effort in 2005 to monitoring and responding to the implementation of PCAOB Auditing Standard No. 2. The standard fulfills the requirements of Sections 103 and 404 of the Act that auditors examine the effectiveness of, and attest to management's assessment of, internal control over financial reporting.

In a related action, the Board developed and adopted Auditing Standard No. 4 to guide auditors when they are asked to assess a company's assertion that it has adequately addressed a previously reported material weakness in internal control over financial reporting before the company's year-end assessment of internal control overall.

The Board also adopted new ethics and independence rules relating to auditors' provision of tax services to audit clients. These rules address, among other things, recent public concerns about auditors' involvement with crafting and selling aggressive tax shelters to audit clients as well as auditors' work on the personal taxes of certain corporate executives of audit clients.

The Board also issued guidance, in the form of staff questions and answers, for attest engagements regarding XBRL (eXtensible Business Reporting Language) financial information furnished under the XBRL Voluntary Financial Reporting Program on the Securities and Exchange Commission's EDGAR System.

AUDITING STANDARD NO. 2

For many public companies and their auditors, 2005 was the first year of reporting under the rules set by the SEC and the PCAOB to implement the internal control requirements of the Sarbanes-Oxley Act, including testing of and reporting on companies' internal control over financial reporting.

Throughout the year, the PCAOB undertook a number of initiatives to both collect feedback and offer guidance on the application of Auditing Standard No. 2.

On April 13, 2005, the Board and the Commission heard from issuers, auditors, investors, and others at a roundtable discussion of first-year experiences with the requirements related to internal control. While many of the participants noted that the requirements produced benefits, including a more intense focus on internal control by corporate management, many participants also noted significant costs related to requirements and attributable to a variety of factors, including deferred maintenance of internal control and inefficient efforts to meet the requirements. The Board and the Commission

responded with additional guidance, including a Board policy statement, on May 16, 2005.

The Board policy statement described several ways in which the auditor's work pursuant to Auditing Standard No. 2 can be performed more effectively and efficiently. It also described the PCAOB's intention to supervise implementation of the standard, from providing additional guidance to make audits of internal control more effective and cost-efficient to driving improvements in implementation through PCAOB inspections of registered public accounting firms.

The policy statement specifically expressed the Board's view that, to properly plan and perform an effective audit under Auditing Standard No. 2, auditors should—

- integrate their audits of internal control with their audits of the client's financial statements;
- exercise judgment to tailor their audit plans to the risks facing individual audit clients;
- use a top-down approach that begins with company-level controls, and use the risk assessment required by the standard to eliminate from further consideration those accounts that have only a remote likelihood of containing a material misstatement;
- take advantage of the significant flexibility that the standard allows to use the work of others; and
- engage in direct and timely communication with audit clients.

The PCAOB also responded to the April 13 roundtable with additional guidance in the form of staff questions and answers about Auditing Standard No. 2. The Board also devoted the June 8-9, 2005, meeting of its Standing Advisory Group to a discussion of audits of internal control.

On November 30, 2005, the Board issued a Report on the Initial Implementation of Auditing Standard No. 2. The observations in the report were based in significant part on information obtained in the PCAOB's inspection process, which, in the 2005 cycle, included review of portions of a limited selection of audits of internal control over financial reporting.

The Board reported that both firms and issuers faced significant challenges in the first year of implementation, including strains on available resources; a shortage of staff with prior training and experience in designing, evaluating, and testing controls; and the limited timeframe that issuers and auditors had to implement the Act's internal control requirements. These challenges were compounded in cases in which companies needed to make significant improvements in their internal control systems to make up for deferred maintenance of those systems.

The Board also reported that some audits performed under these difficult circumstances were not as effective or efficient as Auditing Standard No. 2 intends and as the Board expects they can be in the future. The Board noted that, based on first-year experiences and on previous Board guidance, accounting firms stated that they had modified their audit methodologies and training materials in a number of areas to improve the effectiveness and efficiency of their internal control audits.

AUDITING STANDARD NO. 4

Based in part on guidance from the Standing Advisory Group, the Board in 2005 proposed and adopted PCAOB Auditing Standard No. 4, which provides for an auditor to report on whether a previously reported material weakness in internal control over financial reporting continues to exist as of a date specified by management.

When a company that has previously reported a material weakness acts on that deficiency so that the material weakness no longer exists, the company may, during the course of a reporting year, seek an auditor's opinion on this issue. To facilitate implementation of the Act's internal control requirements, and to provide for additional assurance regarding the reliability of public company financial reporting, the Board developed a new auditing standard for auditors to provide this assurance on a voluntary basis when, in the company's judgment, such assurance would be appropriate. The Board adopted the standard on July 26, 2005, and it was approved by the SEC on February 6, 2006.

ETHICS AND INDEPENDENCE RULES

The Sarbanes-Oxley Act directs the Board to establish ethics standards to be used by registered public accounting firms in the preparation and issuance of audit reports, as well as rules on auditor independence.

The Board proposed ethics rules on auditor independence and the auditors' provision of tax services to audit clients on December 14, 2004, and received more than 800 written comments on the proposal. After considering the comments, the Board adopted the rules on July 26, 2005. The SEC approved the rules on April 19, 2006.

The rules are intended to accomplish several objectives. An ethics rule codifies the principle that persons associated with a registered public accounting firm (e.g., individual accountants) can be held responsible when certain of their actions contribute to a firm's violation of relevant laws, rules, or professional standards. The rules introduce a foundation for the independence component of the Board's ethics rules by establishing a general obligation requiring a registered public accounting firm and its associated persons to be independent of the firm's audit clients throughout the audit and professional engagement period.

The rules identify circumstances in which the provision of tax services impairs an auditor's independence, including services related to marketing, planning, or opining in favor of the tax treatment of a transaction that is a confidential transaction or a tax treatment of a transaction that is based on an aggressive interpretation of applicable tax laws and regulations.

The rules also treat registered public accounting firms as not independent of their audit clients if they enter into contingent fee arrangements with those clients or if the firms provide tax services to certain members of management who serve in financial reporting oversight roles at an audit client or to immediate family members of such persons.

The rules further implement the Act's pre-approval requirement by strengthening the auditor's responsibilities in connection with seeking audit committee pre-approval of tax services. Specifically, the rules require a registered public accounting firm that seeks such pre-approval to describe proposed tax services engagements, in writing, for the audit committee; to discuss with the audit committee the potential effects of the services on the firm's independence; and to document the substance of that discussion.

STANDING ADVISORY GROUP

The Board met three times in 2005 with its Standing Advisory Group—a body of experts established by the Board to make recommendations regarding auditing and professional practice standards. The group comprised 30 individuals with expertise in a variety of fields, including accounting, auditing, corporate finance, corporate governance, and investing in public companies.

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

The group's 2005 meetings were open to the public and broadcast through the Board's Web site to make the discussions available to as wide an audience as possible.

The agenda for each meeting was accompanied by publicly available briefing papers on the topics to be discussed.

At the February 16, 2005, meeting, the group discussed the reporting model for audits, risk assessment in financial statement audits, and emerging issues. On June 8 and 9, 2005, the Standing Advisory Group convened in a meeting exclusively devoted to issues related to audits of internal control, including multi-location audits, communications with audit committees, and reporting on material weaknesses. The group heard from panels of auditors and issuers about their experiences with audits of internal control.

In the final meeting of the year, October 5-6, 2005, the group discussed the sufficiency of the Board's interim standards on reporting and obtaining reasonable assurance that a public company's financial statements are free of material misstatements to support an unqualified opinion on the financial statements. The group also discussed engagement quality review, communications with audit committees, and future standards-setting priorities.

FUTURE STANDARDS-SETTING

At the Standing Advisory Group meeting on October 5, 2005, the Board sought advice on a series of topics for consideration as possible priorities in 2006 for auditing and related professional practice standards. Among the topics that the staff presented were:

- Engagement quality review;
- Fraud, including related parties and confirmations;
- Communications with audit committees;
- Principles of reporting, including the meaning of "present fairly in conformity with GAAP," consistency of GAAP application, and adequacy of financial statement disclosure;
- Fair value, including the use of specialists;
- Risk assessment, including audit planning and procedures, and evaluating audit findings;
- Quality control, including independence quality controls; and
- Codification of PCAOB standards.

The priorities list was prepared for discussion with the Standing Advisory Group and reflects a broader list of topics than the Board anticipates addressing in 2006. Ultimately, the Board will decide which standards are proposed and at what time. Priorities could change if the Board identifies emerging issues that require attention.

Enforcement and Investigations

The Board is authorized by the Sarbanes-Oxley Act to investigate auditor conduct that may violate the laws, rules, or standards within the Board's jurisdiction. The Board is further empowered to impose a range of disciplinary sanctions against registered accounting firms and associated persons who violate those laws, rules, or standards.

The Board publicly announced settled disciplinary proceedings against three registered firms and five associated persons in 2005. The Board revoked the PCAOB registration of each firm named in those actions, thereby preventing the firm from performing audits of public companies. The Board's orders also barred three individuals from associating with any registered public accounting firm, and two individuals were censured.

In two cases, the Board found that the firms and associated persons engaged in "intentional or knowing conduct, including reckless conduct" that resulted in violations of PCAOB auditing or independence standards and, therefore, merited revocation of the firms' registration. In another case, the Board found that the respondents had concealed information from the Board and submitted false information in connection with a PCAOB inspection. In each case, the respondents consented to the Board-ordered sanctions without admitting or denying the findings set forth in the orders. The Board's orders in these cases are posted on the PCAOB Web site.

In 2005, the Board's Division of Enforcement and Investigations launched numerous informal inquiries and, with Board approval, 17 formal investigations of registered firms and associated persons. The Board's investigations are, by law, confidential and nonpublic.

Informal inquiries are preliminary fact-finding investigations to determine whether a sufficient basis exists for the Board to authorize a formal investigation. In informal inquiries, the Division may request documents, information, or testimony from any person. Most of the Division's formal investigations commence as informal inquiries.

When the Board authorizes a formal investigation, the Division may demand that any registered firm and associated person provide sworn testimony or documents relevant or material to the investigation. The Division may also inspect the books and records of such firms or associated persons to verify the completeness and accuracy of any documents or information supplied in an investigation.

The results of the investigations may lead the Board to institute disciplinary proceedings, which carry the prospect of a range of sanctions, from requiring additional professional training to more severe penalties, including significant money penalties and the possible suspension or revocation of registration, which will effectively bar the firm or associated person from auditing publicly traded companies.

The Division's investigations and inquiries arise from a number of sources, including PCAOB inspections of registered firms, PCAOB's Office of Research and Analysis, other regulators, public disclosures of restatements and auditor changes, news reports, and confidential tips. To encourage a flow of useful information, the Board maintains an online "PCAOB Center for Enforcement Tips, Complaints, and Other Information," as well as a toll-free telephone number. Through these means, individuals are encouraged to provide the Board with information concerning potential violations of the laws, rules, and standards within the Board's jurisdiction.

The Division works closely with the SEC's Division of Enforcement to coordinate many of its investigations. In appropriate circumstances, the Act provides that information gathered in Board investigations may also be shared with the U.S. Department of Justice, certain federal banking regulators, state attorneys general, and appropriate state regulatory authorities.

Internal Oversight and Performance Assurance

The Board's Office of Internal Oversight and Performance Assurance provides the Board assurance with respect to the quality, accountability, and operational efficiency of PCAOB programs and operations. IOPA conducts performance reviews of PCAOB programs and operations, provides real-time quality assurance to the Board, and may also receive and review allegations of wrongdoing by PCAOB employees.

IOPA conducts its performance reviews in accordance with the Government Accountability Office's Government Auditing Standards (the Yellow Book). During 2005, IOPA performed independent reviews and issued reports on the Board's human resource activities; finance office activities; and inspections procedures. These reports are part of a series of performance reviews that focus on the progress of key PCAOB programs and functions in establishing effective and appropriate internal controls over its operations.

HUMAN RESOURCE OPERATIONS

IOPA's report identified many ongoing initiatives that have facilitated the hiring necessary to fulfill the statutory missions of the PCAOB. This report also noted that in order for the Board to reach its goal of 220 inspectors by the end of 2005, the rate of hiring experienced accountants needed to increase substantially. IOPA predicted that the effect of competitive employment market conditions on the PCAOB's ability to hire as well as on attrition of PCAOB employees could make this challenge even more pronounced.

FINANCE FUNCTION

IOPA's review included an analysis of certain of the Chief Financial Officer's areas of responsibility: budgeting, financial reporting, accounts receivable, accounts payable, payroll, travel and expense reimbursement, and fixed assets. IOPA reviewed established policies, procedures, and controls and interviewed responsible finance office personnel.

Based on detailed tests of specific transactions and processes, IOPA concluded that, overall, controls generally worked as described and transactions were accurately recorded. Opportunities also existed, however, for the finance staff to strengthen financial controls by completing a number of planned initiatives. IOPA recommended the CFO work with the Board to assess the need for providing additional financial and performance data to managers; fully document the PCAOB's budgeting process; and analyze certain costs associated with processing and reviewing registration applications.

INSPECTIONS ACTIVITIES

This review focused on the processes established by the Board and the PCAOB's Division of Registration and Inspections to inspect registered accounting firms. As part of this review, IOPA examined documentation concerning a range of policy and procedures for conducting and reporting on inspections, as well as such administrative matters as scheduling, training, and performance management.

IOPA concluded that the division has significant infrastructure in place to guide and communicate the steps and procedures required to conduct inspections. In response to IOPA's recommendations, the Director of the Division of Registration and Inspections described a number of program enhancements, including creating a manual for the conduct of large firm inspections; preparing a master inventory of all inspections guidance; providing clarification of the training policy for inspectors; and working with other Board offices to ensure appropriate information technology solutions and enhancements.

Financial Review

PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

Year Ended December 31, 2005

The year 2005 was the third operating year for the Public Company Accounting Oversight Board. Throughout the year, the PCAOB continued much of the staffing and infrastructure development required to support the key activities that were commenced in the second half of 2003 and continued throughout 2004.

Each year, the PCAOB develops a budget that must be approved by the Securities and Exchange Commission, as required by the Sarbanes-Oxley Act of 2002. On December 30, 2004, the Board adopted a 2005 budget of approximately $136 million, which was approved by the SEC on March 3, 2005.

STATEMENTS OF FINANCIAL POSITION

The PCAOB financial statements have been prepared in accordance with U.S. generally accepted accounting principles and are presented pursuant to Statement of Financial Accounting Standards No. 117, *Financial Statements of Not-for-Profit Organizations* (SFAS No. 117). In accordance with SFAS No. 117, the net assets of the PCAOB are not subject to restrictions and therefore all have been classified as unrestricted in the financial statements. The PCAOB's unrestricted net assets increased by approximately $31 million in 2005. This was a result of lower expenditures in a number of program areas, particularly registration and inspections, due to slower than expected hiring, and less than anticipated spending on information technology. The PCAOB's unrestricted net assets for 2004 and 2005 primarily consist of its investments in fixed assets, particularly technology hardware and software, and amounts to fund operations in the subsequent year prior to collection of that year's accounting support fees.

Cash and cash equivalents

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

Cash and cash equivalents also include cash collected on behalf of the Financial Accounting Standards Board (FASB). The Financial Accounting Foundation (FAF) designated the PCAOB as the collection agent for invoicing and collection of the 2004 and 2005 FASB accounting support fees, as authorized by the Sarbanes-Oxley Act. The cash and cash equivalents include approximately $67,000 and $19,000 of cash collected on behalf of the FASB at December 31, 2005 and 2004, respectively. Corresponding amounts were included in accounts payable and other liabilities in 2005 and 2004. The PCAOB earned and was paid approximately $210,000 in both 2005 and 2004 from FASB in its capacity as a billing and collection agent for FASB's support fees.

Short-term investments

In June 2005, the PCAOB began investing in U.S. Treasury bills in order to earn additional yield on its cash balance. As of December 31, 2005, the Board had approximately $52.6 million invested in Treasury bills.

Accounts receivable

Accounts receivable consist of PCAOB's accounting support fees from public companies. Accounts receivable related to accounting support fees from public companies were approximately $45,000 and $39,000 as of December 31, 2005 and 2004, respectively. This represents a collection rate of approximately 99.9% of accounting support fees in both years.

Prepaid expenses and other assets

Prepaid expenses and other assets of approximately $2.3 million and $1.1 million at December 31, 2005 and 2004, respectively, consist primarily of cash paid in advance for rent, insurance, maintenance contracts, and data and media subscriptions. The increase in prepaid expenses for rent and maintenance contracts relates primarily to the opening and expansion of new offices in 2005, and the prepaid expenses for data and media subscriptions relate to increased staffing. The increase in other assets relates primarily to refunds for local taxes paid in 2005 and insurance premiums.

Furniture and equipment, leasehold improvements and technology

During 2005 and 2004, the PCAOB invested approximately $14.2 million and $17.4 million, respectively, in furniture and equipment, leasehold improvements, and information technology to build the infrastructure of the organization. The decrease is largely attributable to a decrease in spending on IT infrastructure for a maturing organization. As of December 31, 2005, the PCAOB had established its Washington, D.C., headquarters and seven regional offices in New York City, Atlanta, Chicago, Dallas, Denver, Orange County, and San Francisco, in addition to a Northern Virginia office for its information technology group.

The PCAOB's investment in technology, furniture, and leaseholds continues to reflect the development of operational infrastructure, telecommunications, security, and software. Software acquisition is a mixture of commercial off-the-shelf products and certain specific proprietary applications. For each proprietary system, the PCAOB considered the costs and benefits of making or buying the system, taking into account the cost, technology, use, and security. In each instance, the PCAOB found that the benefits of building the system in-house outweighed the benefits of utilizing an existing system. The following chart reflects capital expenditures for 2005 and 2004:

Capital Expenditures

	2005	2004
Technology—program activities	$ 1,660,000	$ 8,874,000
Technology—supporting activities	4,110,000	6,714,000
Furniture and leasehold improvements	6,862,000	1,766,000
Technology development in process	1,599,000	—
Total	$14,231,000	$17,354,000

Technology development in process represents capital expenditures that have been capitalized but not yet depreciated as of the end of 2005 because the assets have not been placed in service. It is anticipated that these assets will be placed in service in the first half of 2006.

Accounts payable and other liabilities

Accounts payable and other liabilities for both years are primarily made up of year-end accruals. The increase in 2005 is related to an increase in trade payables and liabilities arising from increased headcount.

STATEMENTS OF ACTIVITIES

Operating Revenue

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

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

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

In 2005, the PCAOB issued invoices to approximately 9,600 issuers, as compared to approximately 8,800 issuers in 2004. The increase in the number of issuers primarily is due to changes in market capitalization per issuer. The PCAOB recorded approximately $136.0 million and $101.1 million in 2005 and 2004, respectively, in accounting support fee revenue.

In 2005, approximately 45% of the issuers billed received invoices for $1,000 or less, and the largest 1,000 issuers received invoices for approximately 84% of the total fees. The accompanying chart reflects the distribution of fee levels by issuers.

Assessment of Accounting Support Fees

FEES	NUMBER OF ISSUERS 2005	2004
$100–500	2,750	2,996
$501–1,000	1,565	1,457
$1,001–5,000	2,842	2,461
$5,001–10,000	906	707
$10,001–50,000	1,083	863
$50,001–100,000	201	170
$100,001–500,000	203	136
$500,001–1,000,000	29	21
$1,000,001+	14	10
Total	9,593	8,821

Combined, publicly traded companies contributed approximately 95% of the total fees paid in 2005, while open-end mutual funds provided about 4.2%, and other investment companies paid the remainder.

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

In 2005, the PCAOB collected approximately $66,000 from registration applicants and approved the registration of 244 firms. In 2004, the PCAOB collected $304,000 from registration applicants and approved the registration of 688 firms. At the end of 2005, 1,591 accounting firms were registered with the PCAOB.

Operating Expenses

Program Activities

The Sarbanes-Oxley Act gives the PCAOB four primary responsibilities to carry out its mission: registration, inspections, standards-setting, and enforcement. These responsibilities are designated as program activities for the PCAOB and are so reflected in the financial statements. The financial statements continue to reflect two additional program activities representing the progression of the organization from its start-up stage to a more mature operation. Research and Analysis is designated as a program activity given its role in providing assessments of risks to the Board's oversight programs, particularly inspections. Board and related activities reflect the Board's focus on its regulatory responsibilities under the Act. Included in Board and related activities are the PCAOB's international initiatives.

Costs associated with these programs include salaries, benefits, rent, program-specific technology costs, and other direct operating expenses relating to the specific activity.

Registration and Inspections

During 2005, the Board continued to register public accounting firms. The number of public accounting firms that are registered increased from 1,423 firms as of December 31, 2004, to 1,591 firms as of December 31, 2005. The increase in registered firms is largely due to the registration of non-U.S. firms.

In 2005, the Board conducted inspections of 265 domestic registered public accounting firms, including the eight largest U.S. firms, which require annual inspections. In addition, the Board began its inspections of non-U.S. registered firms, of which 16 were inspected, including one that requires an annual inspection. The Board continued its efforts to recruit talented employees and invest in technology for inspections to support the Board in fulfilling its mandate. Inspections' headcount increased from 116 to 200 during 2005.

The increase in program costs from approximately $30.9 million in 2004 to approximately $48.6 million in 2005 is primarily related to the increase in inspections staff. In addition, spending on program-specific information technology for registration increased as the PCAOB continued to develop its Web-based registration system, adding infrastructure and functionality for future reporting by registered accounting firms.

Enforcement

In 2005, the division launched numerous formal and informal investigations of registered firms. The increase in program costs from approximately $1.9 million in 2004 to approximately $5.0 million in 2005 is directly related to the increase in headcount from 9 in 2004 to 24 in 2005.

Standards-setting

The Office of the Chief Auditor continues to advise and assist the Board in fulfilling its mandate to set standards for auditing and related attestations, quality control, ethics, and independence for the audits of public companies. During 2005, the Office of the Chief Auditor headcount increased from 12 to 14, resulting in the increase in program costs from approximately $3.6 million in 2004 to approximately $4.0 million in 2005.

Office of Research and Analysis

The Office of Research and Analysis (ORA) was formed in 2005 by combining the operations of the Office of Financial Analysis and Risk Assessment and the Risk Analysis group of the Division of Registration and Inspections. ORA's primary role is to identify and assess the risk of undetected misstatements of the audited financial statements of public companies and assess the effects of the PCAOB's activities on public company audits. The increase in program costs from approximately $1.1 million in 2004 to approximately $5.3 million in 2005 is primarily related to the increase in staff from 12 in 2004 to 23 in 2005.

Board and Related Activities

During 2005, the Board and related activities remained fairly constant in headcount and operating costs. Program costs were approximately $6.9 million in 2004 and approximately $7.0 million in 2005. The Board and its staff continued their outreach efforts domestically and internationally, including meetings with non-U.S. regulators of public accounting firms in furtherance of the Board's mission to oversee non-U.S. accounting firms that audit public companies.

Supporting Activities

Supporting activities continue to constitute a significant percentage of the PCAOB's 2005 operating expenses, comprising 35% of the expenses in 2005 as compared to 37% in 2004. During 2005, the PCAOB continued to build the corporate infrastructure to support the program areas. Supporting activities comprise three areas: administration and general; communications; and information technology.

Administration and General

Administration and general expenses include indirect costs relating to program activities in addition to operating costs for the following areas: Administration, Finance, General Counsel, Human Resources, and Internal Oversight and Performance Assurance. Program costs for these areas increased from approximately $10.6 million in 2004 to approximately $13.9 million in 2005. Headcount in these areas increased from 43 in 2004 to 62 in 2005. The increase in headcount is primarily attributable to increases in Administration to support the larger staff in program activities and the larger number of regional offices and Human Resources, reflecting the Board's commitment to recruit and retain experienced staff.

Communications

Communications includes the operating costs for the government relations and public affairs offices. The headcount for these activities from 2004 to 2005 remained relatively consistent. As a result, costs increased slightly from approximately $2.0 million in 2004 to approximately $2.1 million in 2005.

IT Infrastructure, Security, and Telecommunications

Costs for IT infrastructure, security, and telecommunications include related headcount and depreciation associated with capital expenditures that are not directly attributable to program activities. Expenses increased from approximately $14.0 million in 2004 to approximately $22.2 million in 2005. The increase is related to the support of the overall increase in the PCAOB's headcount and regional offices in addition to the development and deployment of specialized IT programs for the scheduling and performance of inspections and the performance of risk analysis.

Interest income and other

The increase in interest income from 2004 to 2005 is attributed to the increase in the average monthly cash balance held in 2005 due to timing and amount of 2005 invoices.

Statements of Financial Position

PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

December 31, 2005 and 2004

	2005	2004
Assets		
Cash and cash equivalents (Note 2)	$ 21,888,470	$40,654,476
Short-term investments (Note 2)	52,645,119	—
Accounts receivable	44,672	38,857
Prepaid expenses and other assets	2,322,950	1,109,826
Furniture and equipment, leasehold improvements, and technology, net (Note 3)	27,525,674	25,543,450
Total Assets	$104,426,885	$67,346,609
Liabilities and Net Assets		
Liabilities		
Accounts payable and other liabilities	$ 9,757,210	$ 6,893,395
Deferred rent (Note 4)	7,042,939	3,542,970
Total Liabilities	16,800,149	10,436,365
Net Assets		
Unrestricted	87,626,736	56,910,244
Total Net Assets	87,626,736	56,910,244
Total Liabilities and Net Assets	$104,426,885	$67,346,609

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

Statements of Activities

PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

Years Ended December 31, 2005 and 2004

	2005	2004
Changes in Unrestricted Net Assets		
Operating Revenue		
Fees from issuers (Note 2)	$136,005,200	$101,093,100
Fees from registering accounting firms (Note 2)	66,000	304,000
Total operating revenue	136,071,200	101,397,100
Operating Expenses		
Program activities (Note 2)		
Registration and inspections	48,580,410	30,896,018
Enforcement	5,044,595	1,901,298
Standards-setting	4,038,929	3,636,440
Research and analysis	5,327,626	1,081,382
Board and related activities	6,954,959	6,874,092
Supporting activities		
Administration and general	13,847,793	10,556,050
Communications	2,087,970	2,022,850
IT infrastructure, security and telecommunications	22,165,962	13,983,052
Total operating expenses	108,048,244	70,951,182
Operating Income	28,022,956	30,445,918
Interest Income and Other	2,693,536	665,524
Increase in Unrestricted Net Assets	30,716,492	31,111,442
Unrestricted Net Assets, beginning of year	56,910,244	25,798,802
Unrestricted Net Assets, end of year	$ 87,626,736	$ 56,910,244

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

Statements of Cash Flows

PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

Years Ended December 31, 2005 and 2004

	2005	2004
Cash Flows from Operating Activities		
Cash received from issuers	$ 135,993,982	$103,015,503
Cash received from registering accounting firms	71,403	304,847
Interest income and other	2,693,536	665,524
Cash paid to suppliers and employees	(90,648,807)	(60,961,046)
Net cash provided by operating activities	48,110,114	43,024,828
Cash Flows from Investing Activities		
Purchases of furniture and equipment, leasehold improvements and technology	(14,231,001)	(17,354,585)
Purchases of short-term investments	(152,105,921)	—
Proceeds from sales of short-term investments	99,460,802	—
Net cash used in investing activities	(66,876,120)	(17,354,585)
Net (Decrease) Increase in Cash and Cash Equivalents	(18,766,006)	25,670,243
Cash and Cash Equivalents, beginning of year	40,654,476	14,984,233
Cash and Cash Equivalents, end of year	$ 21,888,470	$ 40,654,476
Reconciliation of Increase in Unrestricted Net Assets		
to Net Cash Provided by Operating Activities:		
Increase in Unrestricted Net Assets	$ 30,716,492	$ 31,111,442
Reconciliation Adjustments		
Depreciation and amortization	12,248,777	8,242,013
(Increase) decrease in accounts receivable	(5,815)	1,923,250
Increase in prepaid expenses and other assets	(1,213,124)	(242,610)
Increase in accounts payable and other liabilities	2,863,815	1,475,897
Increase in deferred rent	3,499,969	514,836
Net Cash Provided by Operating Activities	$ 48,110,114	$ 43,024,828

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

Notes to the Financial Statements

PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

December 31, 2005 and 2004

NOTE 1—NATURE OF ACTIVITIES

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

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

NOTE 2—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

Registration and Inspections, Enforcement, Standards-setting, Research and Analysis, and Board and Related Activities are the program activities for the PCAOB. Costs associated with these program activities include salaries, benefits, rent, program-specific technology costs, and other direct operating expenses relating to the above activities. Indirect costs are not allocated to program activities, but are included in supporting activities.

Program Activities of the PCAOB

- ***Registration and Inspections.*** The Act requires that an accounting firm be registered with the PCAOB if it prepares or issues, or plays a substantial role in the preparation or issuance of, any audit report with respect to an issuer. The PCAOB reviews the registration application of each public accounting firm that chooses to register with it. If the PCAOB approves its application, that registered public accounting firm is subject to the PCAOB's continuing program of inspections. This program assesses each firm's compliance with the Act, the rules of the PCAOB, the rules of the SEC, and professional standards in connection with the firm's performance of audits, issuance of audit reports, and related matters involving issuers, as defined in the Act.
- ***Enforcement.*** The Act grants the PCAOB broad investigative authority over registered public accounting firms and persons associated with such firms. The PCAOB has authority to impose disciplinary sanctions when it determines that one or more of the above has violated the laws, rules, or standards within the PCAOB's jurisdiction.
- ***Standards-setting.*** The PCAOB establishes auditing, related attestation, quality control, independence, and ethics standards to be used by registered public accounting firms in the preparation and issuance of audit reports.
- ***Research and Analysis.*** Office of Research and Analysis was formed in 2005 by combining the operations of the Office of Financial Analysis and Risk Assessment and the Risk Analysis group of the Division of Registration and Inspections. The Office of Research and Analysis collects, analyzes, and assimilates information from multiple sources and provides the PCAOB with assessments of risks that may influence public companies or their auditors to provide financial

statements or other public information that is not fairly presented in all respects.

- ***Board and Related Activities.*** In accordance with the Act, the PCAOB Board is responsible for carrying out the PCAOB's regulatory programs and operations. Although the PCAOB Board has established an experienced professional staff in each of its program areas, the PCAOB Board remains responsible for determining the PCAOB's action in each program area, as well as for performing such other duties or functions as the PCAOB Board (or the SEC, by rule or order) determines are necessary or appropriate to promote high professional standards among, and improve the quality of audit services offered by, registered public accounting firms and their associated persons, or otherwise to carry out the Act, in order to protect investors or further the public interest. In addition, the PCAOB Board engages in communication and other outreach efforts with the accounting profession, the investing public, public companies, and other U.S. and non-U.S. regulators concerning, among other things, the PCAOB's mission, programs, and initiatives, and its oversight of the accounting profession. Also included in Board and Related Activities are the PCAOB's international initiatives.

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

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

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

Cash Held for Others under Agency Agreement. On behalf of the Financial Accounting Standards Board (the "FASB"), the Financial Accounting Foundation (the "FAF") designated the PCAOB as the collection agent for invoicing and collection of the 2005 and 2004 FASB accounting support fees. The PCAOB earned and was paid $209,400 in both 2005 and 2004 from the FAF for acting as the collection agent. This amount is included in interest income and other in the accompanying statements of activities. Otherwise, the PCAOB recognizes no revenue or expense related to this relationship and maintains a separate bank account for all fees collected on behalf of the FASB. As of December 31, 2005 and 2004, the PCAOB had $67,547 and $19,418, respectively, included in cash and cash equivalents related to the FASB. A corresponding $67,547 and $19,418 was included in accounts payable and other liabilities for amounts due to the FASB as of December 31, 2005 and 2004, respectively.

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

Short-Term Investments. Short-term investments consist of U.S. Treasury bills with maturities of six months from the date of acquisition. These investments are carried at market value, which approximates fair value. As of December 31, 2005, the PCAOB's short-term investments in U.S. Treasury bills totaled $52,645,119. Income earned on these investments, including realized and unrealized gains and losses, in accordance with FASB Statement No. 124, *Accounting for Certain Investments Held by Not-for-Profit Organizations,* was $1,377,199 during the year ended December 31, 2005.

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

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

Reclassifications. Certain amounts in the 2004 financial statements have been reclassified to conform with the current year's presentation.

NOTE 3—FURNITURE AND EQUIPMENT, LEASEHOLD IMPROVEMENTS AND TECHNOLOGY

These assets consist of the following at December 31, 2005 and 2004:

	2005	2004
Technology		
Hardware	$ 9,844,770	$ 8,472,973
Purchased and developed software	24,990,236	20,978,275
Leasehold improvements	7,431,619	3,476,906
Furniture and equipment	6,133,061	3,056,627
Technology development in process	1,599,314	—
Total	49,999,000	35,984,781
Accumulated depreciation and amortization	(22,473,326)	(10,441,331)
	$ 27,525,674	$ 25,543,450

Depreciation and amortization expense was $12,248,777 and $8,242,013 in 2005 and 2004, respectively.

NOTE 4—LEASE COMMITMENTS

As of December 31, 2005, the PCAOB occupied office space in Washington, DC; New York, New York; Northern Virginia; San Francisco, California; Orange County, California; Atlanta, Georgia; Dallas, Texas; Chicago, Illinois; and Denver, Colorado, on leases that expire from 2006 to 2014. The leases include provisions for scheduled rent increases over the respective terms. Rent is being expensed using the straight-line method over the respective lease terms. Rent under this method was $5,050,560 and $3,097,378 in 2005 and 2004, respectively. Deferred rent that has been expensed but will not be paid until future years totaled $7,042,939 and $3,542,970 as of December 31, 2005 and 2004, respectively, and is being adjusted as payments are made over the remaining lives of the office leases.

Minimum rental commitments under the office leases as of December 31, 2005 are as follows:

Year ending December 31	
2006	$ 5,175,885
2007	5,264,045
2008	5,382,724
2009	5,494,055
2010	5,536,222
Thereafter	19,930,583
	$46,783,514

NOTE 5—RETIREMENT BENEFIT PLAN

The PCAOB has a defined contribution retirement plan which covers active employees. The PCAOB matches contributions in an amount equal to 100 percent up to 6 percent of the eligible compensation. The PCAOB's contributions become fully vested immediately. The PCAOB's contributions to employees' accounts were $2,673,785 and $1,496,782 for 2005 and 2004, respectively.

NOTE 6—SUBSEQUENT EVENTS

In February 2006, the PCAOB entered into an eight-year operating lease in New York, New York, commencing in 2006 and ending in 2014. Minimum rental commitments under this lease total $18,394,862. The new space will supersede the current New York location, for which the current lease expires in October 2006.

NOTE 7—LITIGATION AND CONTINGENCIES

On February 7, 2006, the Free Enterprise Fund and Beckstead and Watts, LLP filed a civil action in the U.S. District Court for the District of Columbia against the PCAOB and its current Board members in their official capacities (Case No. 1:06CV00217). The action alleges that "the Board and all power and authority exercised by it violate the Constitution." The PCAOB intends to defend this action vigorously.

Independent Auditors' Report

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

We have audited the accompanying statements of financial position of the Public Company Accounting Oversight Board (the PCAOB) as of December 31, 2005 and 2004, and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of the PCAOB's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with U.S. generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the PCAOB's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Public Company Accounting Oversight Board as of December 31, 2005 and 2004, and the changes in its net assets and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

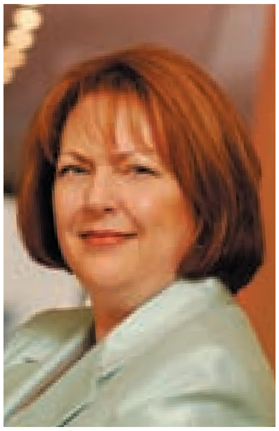
Beers & Cutler PLLC

Washington, DC
February 14, 2006

PCAOB

Public Company Accounting Oversight Board

Bill Gradison
Acting Chairman



Kayla J. Gillan
Board Member

Daniel L. Goelzer
Board Member

Charles D. Niemeier
Board Member

Washington Office
1666 K Street, NW
Washington, DC 20006

New York Office
1251 Avenue of the Americas
New York, New York 10020

Northern Virginia Office
19955 Highland Vista Drive
Ashburn, Virginia 20147

Atlanta Office
3399 Peachtree Road, NE
Atlanta, Georgia 30326

Chicago Office
111 South Wacker Drive
Chicago, Illinois 60606

Dallas Office
5215 N. O'Connor Boulevard
Irving, Texas 75039

Denver Office
1225 17th Street
Denver, Colorado 80202

Orange County Office
2030 Main Street
Irvine, California 92614

San Francisco Office
901 Mariner's Island Boulevard
San Mateo, California 94404

Careers
(800) 810-0870

International Affairs
(202) 207-9252

Public Affairs
(202) 207-9227

Government Relations
(202) 207-9170

PCAOB

Public Company Accounting Oversight Board

1666 K Street, NW
Washington, DC 20006-2803
(202) 207-9100
www.pcaobus.org