

“audit engagement team” members and their “audit clients.”¹⁷

The concept of a “cooling-off” period before an auditor can take a position at the audit client was previously considered by the Independence Standards Board.¹⁸ In considering a cooling-off period, the Independence Standards Board noted that a mandated cooling-off period for partners and professional staff might create a greater appearance of independence between the accounting firm and the registrant.¹⁹ Ultimately, however, the Independence Standards Board provided for an alternative to a cooling-off period. The Independence Standards Board concluded that:

An audit firm’s independence is impaired with respect to an audit client that employs a former firm professional who could, by reason of his or her knowledge of and relationships with the audit firm, adversely influence the quality or effectiveness of the audit, unless the firm has taken steps that effectively eliminate such risk.²⁰

Independence Standards Board’s Standard No. 3 specifically notes that additional caution is warranted when it has been less than one year since the professional disassociated him or herself from the firm.²¹ The provisions of the Sarbanes-Oxley Act reflect the view that the passage of time is an additional safeguard to reduce the perceived loss of independence for the audit firm caused by the acceptance of employment by a member of the engagement team with an audit client.

Some commenters²² stated that the rule should apply only to partners on the audit engagement team. However, we believe that the Act is clear that the cooling off period should apply more broadly. Additionally, our proposal would have applied to relationships between members of the audit engagement team and the audit client. Some commenters²³ believe that

extending the requirement to the audit client was too broad. In some situations (such as certain affiliate companies), it could be difficult for the accounting firm and its audit clients to monitor and, in some cases, control the employment relationship.

Our proposed rule did not make a distinction based on the number of hours of audit, review, or attest services provided in determining who would be subject to this rule. The Act refers to individuals who “participated in any capacity in the audit.” Commenters²⁴ noted that not all members of the audit engagement team, as that term is currently defined, necessarily participate in a meaningful audit capacity.

As discussed both in our proposing release and in this release, the term “financial reporting oversight role” refers to any individual who has direct responsibility for oversight over those who prepare the registrant’s financial statements and related information (e.g., management’s discussion and analysis) that are included in filings with the Commission. Some commenters²⁵ stated that the final rule only should apply to the four named positions in the Act (e.g., chief executive officer, controller, chief financial officer, chief accounting officer). Other commenters,²⁶ however, agreed with the Commission’s approach of using the concept of financial reporting oversight role.

In response to the issues raised by commenters,²⁷ we are requiring that when the lead partner, the concurring partner, or any other member of the audit engagement team²⁸ who provides more than ten hours of audit, review or attest services for the issuer accepts a position with the issuer in a financial reporting oversight role within the one year period preceding the commencement of audit procedures for the year that included employment by the issuer of the former member of the audit engagement team, the accounting firm is not independent with respect to

that registrant. Our rule applies to all members of the audit engagement team unless specifically exempted, as discussed later in this section of the release.

We agree with the commenters²⁹ who noted that extending the requirement to the “audit client” might be difficult to monitor because of the potentially broad scope of that defined term—particularly in situations where a member of the audit engagement team begins employment with an affiliate of the audit client.³⁰ Accordingly, the rules that we are adopting apply to employment relationships entered into between members of the audit engagement team and the “issuer.”³¹

The Commission recognizes that, in certain instances, there are individuals who meet the definition of engagement team members while spending a relatively small amount of time on audit-related matters of the issuer. For example, a staff member may be asked to spend one day of time to observe inventory. While the input may have been important to resolving specific aspects of the audit, the staff member likely has not had significant interaction with the audit engagement team or management of the issuer. However, it is likely that those who spent more than a *de minimis* amount of time on the engagement team did participate in a meaningful audit capacity. Because of their roles in the engagement, the lead and concurring partner always should participate in a meaningful audit capacity, regardless of the number of hours spent on the engagement.

In order to provide useful guidance, our rule on conflicts of interest resulting from employment relationships specifies that, other than the lead and concurring partner, an individual³² must provide more than ten hours of service during the annual audit period³³ as a member of the engagement team to have participated in an audit capacity. The Commission previously has considered a threshold based on the number of hours of service and, based on our experience, concluded that use of ten hours of service to the client

¹⁷ See, Rule 2–01(f)(6).

¹⁸ The Independence Standards Board was a private sector body that, from 1997 to 2001, was charged with the responsibility to set auditor independence standards for auditors of the financial statements of SEC registrants. See Financial Reporting Release Nos. 50 (February 18, 1998) and 50A (July 17, 2001).

¹⁹ Independence Standards Board, “Employment with Audit Clients,” *Discussion Memorandum 99–1* (March 12, 1999).

²⁰ Independence Standards Board, “Employment with Audit Clients,” *Standard No. 3* (July 2000).

²¹ *Id.*, ¶ 2(b)(iii).

²² See, e.g., letter from Asahi & Co., dated January 10, 2003; letter from CPA Associates, dated January 3, 2003; letter from International Group of Accounting Firms, dated December 24, 2002.

²³ See, e.g., letter from Eli Lilly and Company, dated January 9, 2003; letter from KPMG, dated January 9, 2003; letter from PricewaterhouseCoopers, dated January 8, 2003; letter from Roland G. Ley, dated January 9, 2003.

²⁴ See, e.g., letter from American Institute of Certified Public Accountants, dated January 9, 2003; letter from KPMG, dated January 9, 2003; letter from Instituted of Chartered Accountants of Scotland, dated January 8, 2003.

²⁵ See, e.g., letter from Eli Lilly and Company, dated January 9, 2003; letter from McGladrey & Pullen LLP, dated January 9, 2003; letter from PricewaterhouseCoopers, dated January 8, 2003; letter from Computer Sciences Corporation, dated January 13, 2003.

²⁶ See, e.g., letter from Consumer Federation of America, dated January 13, 2003.

²⁷ See, e.g., letter from Deloitte & Touche, dated January 10, 2003; letter from KPMG, dated January 9, 2003; letter from PricewaterhouseCoopers, dated January 8, 2003.

²⁸ See, Rule 2–01(f)(7).

²⁹ See, e.g., letter from KPMG, dated January 9, 2003; letter from PricewaterhouseCoopers, dated January 8, 2003.

³⁰ See, Rule 2–01(f)(4).

³¹ See, Section 3(a)(8) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(8)).

³² It should be noted that the ten hour threshold does not apply to the lead or concurring review partner. Such individuals are always subject to these rules, regardless of the number of hours of audit, review or attest services provided.

³³ This includes hours of service provided in reviewing the issuer’s quarterly filing or in providing attest services for the issuer related to the audit.