

constitutes a reasonable basis for distinguishing whether there has been participation on the audit.<sup>34</sup>

The Commission has determined that using the “financial reporting oversight role” is a better test for the scope of the provision than the four particular officers named in the Act. As discussed in the definitions section of this release, the term financial reporting oversight role is not a new concept. Furthermore, in addition to naming four specific positions, the Act also states that the cooling off period applies to “any person serving in an equivalent position for the issuer.” Because issuers do not use uniform titles nor do all named positions (e.g., controller) have uniform duties among all issuers, we believe that a more complete definition of the applicable positions is needed. Furthermore, the term financial reporting oversight role captures other key positions, such as members of the board of directors, who may have significant interaction with the audit engagement team.

While the rule is intended to apply broadly to members of the audit engagement team, we recognize the need to provide accommodations for certain unique situations. In addition to the exemption discussed previously for those who provided ten or fewer hours of audit, review, or attest services, the final rule provides an exception for conflicts that are created through merger or acquisition. Some commenters<sup>35</sup> noted that an individual may have complied fully with the rule and, subsequent to his or her beginning employment with an issuer, the issuer merged with or was acquired by another entity resulting in he or she becoming a person in a financial reporting oversight role of the combined entity and the combined entity being audited by the individual’s previous employer. In such a situation, unless the employment was taken in contemplation of the combination, the individual or the issuer could not be expected to know that his or her employment decision would result in a conflict. Thus, as long as the audit committee is aware of this conflict, the audit firm would continue to be independent under these rules.

Further, we recognize that other unusual situations that may arise. For

example, some commenters<sup>36</sup> have stated that in certain foreign jurisdiction it may be extremely difficult or costly to comply with these requirements. Accordingly, we have provided an additional exemption for emergency or unusual circumstances which we anticipate being invoked very rarely. However, in order for a company to avail itself of this exemption, the audit committee<sup>37</sup> must determine that doing so is in the best interests of investors.

Some commenters<sup>38</sup> stated that determining the time period of the prohibition would be difficult to apply as proposed. We recognize the difficulties when there is, potentially, a different applicable date for each member of the engagement team. For that reason, our final rule adopts a uniform date for all members of the engagement team.

For purposes of this rule, audit procedures are deemed to have commenced for the current audit engagement period the day after the prior year’s periodic annual report (e.g., Form 10-K, 10-KSB, 20-F or 40-F) is filed with the Commission. The audit engagement period for the current year is deemed to conclude the day the current year’s periodic annual report (for example, Form 10-K, 10-KSB, 20-F or 40-F) is filed with the Commission.

To illustrate the application of this rule, assume that Issuer A’s Forms 10-K are filed on March 15, 2003, April 5, 2004, March 10, 2005, and March 30, 2006. Issuer A is a calendar-year reporting entity. The audit engagement periods would be deemed to commence and end:

| Annual Period | Engagement Period Commences | Engagement Period Ends |
|---------------|-----------------------------|------------------------|
| 2003          | March 16, 2003.             | April 5, 2004          |
| 2004          | April 6, .....              | 2004 March 10, 2005    |
| 2005          | March 11, 2005.             | March 30, 2006         |

If audit engagement person B provided audit, review or attest services for Issuer A *at any time* during the 2003 engagement period (March 16, 2003—April 5, 2004), and he or she begins

employment with Issuer A in a financial reporting oversight role prior to March 11, 2005, the accounting firm would be deemed to be not independent with respect to Issuer A. For example, if person B last performed audit, review or attest services for Issuer A on March 24, 2003 and he or she began employment with Issuer A in a financial reporting oversight role prior to March 11, 2005, the accounting firm would be deemed to be not independent with respect to Issuer A. Likewise, if person B provided audit, review or attest services for Issuer A at any time during the 2004 engagement period (April 6, 2004—March 10, 2005) and he or she began employment with Issuer A in a financial reporting oversight role prior to March 31, 2006, the accounting firm would be deemed to be not independent with respect to Issuer A.

The Act specifies that the cooling off period must be one year. Under our rules, the prohibition would require that the accounting firm has completed one annual audit<sup>39</sup> subsequent to when an individual was a member of the audit engagement team. As previously discussed, the measurement period is based upon the dates the issuer filed its annual financial information with the Commission.

With respect to investment companies, we proposed that the employment of a former audit engagement team member in a financial reporting oversight role at any entity in the same investment company complex during the one year period after the completion of the last audit would impair the independence of the accounting firm with respect to the audit client. The proposed rule was designed to prevent a former audit engagement team member from taking a position in an investment company complex where they could influence the preparation of the financial statements or the conduct of the audit.

Several commenters<sup>40</sup> suggested this requirement was too broad and could have unintended consequences, such as preventing a former audit engagement team member on an investment company audit engagement from taking a financial reporting position at an entity in the investment company complex whose operations are unrelated to the investment company. Some

<sup>34</sup> Use of ten hours as a threshold is consistent with the determination of a “covered person” as specified by § 210.2–01(f).

<sup>35</sup> 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.

<sup>36</sup> See, e.g., letter from Deloitte & Touche, dated January 10, 2003; letter from European Commission, dated January 13, 2003.

<sup>37</sup> These rules do not require the company to have an independent audit committee. See, discussion of definitions in this release.

<sup>38</sup> See, e.g., letter from Ernst & Young, dated January 6, 2003; letter from KPMG, dated January 9, 2003; letter from Sullivan & Cromwell LLP, dated January 10, 2003; letter from California Public Employees’ Retirement System, dated January 10, 2003.

<sup>39</sup> As used here, the term annual audit also includes procedures needed to conduct timely review of interim periods as well as procedures needed to attest to the registrant’s internal controls.

<sup>40</sup> See, letter from Deloitte & Touche, dated January 10, 2003; letter from PricewaterhouseCoopers, dated January 8, 2003; letter from Investment Company Institute, dated January 13, 2003.