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## **BRIEFING PAPER**

### **ETHICS CODE**

#### **JUNE 30, 2003 PUBLIC MEETING OF THE BOARD**

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At its public meeting on June 30, 2003, the Public Company Accounting Oversight Board (the "Board" or "PCAOB") will consider whether to adopt, and submit for the approval of the Securities and Exchange Commission ("SEC" or "Commission"), final rules governing the Board's ethical conduct. Section 101 of the Sarbanes-Oxley Act of 2002 (the "Act") requires the Board to establish ethics rules and standards of conduct for Board members and staff. The purpose of the Ethics Code ("EC" or "Code") is to ensure the highest standards of ethical conduct, and to provide the public with confidence in the objectivity of the Board's decisions by seeking to avoid both actual and perceived conflicts of interests.

The Code consists of fourteen sections (EC1 through EC14). Appended to this paper is a list of the titles of each section. The Board's adopting release, which will contain the full text of the Ethics Code, will be posted to the PCAOB Web site, [www.pcaobus.org](http://www.pcaobus.org), as soon as possible.

#### **Overview of the Ethics Code**

As proposed, the Code will apply to the Board members and staff,<sup>1</sup> as well as to designated contractors and consultants.<sup>2</sup> In some circumstances, spouses, spousal

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<sup>1</sup> Certain restrictions apply only to "professional" staff (*i.e.*, those who are exempt from the minimum wage and overtime provisions of the Fair Labor Standards Act (29 USC § 201 et seq.)). These include restrictions on financial interests, acceptance of gifts or honoraria, speaking engagements, and post-employment activities, as well as provisions requiring recusal.

<sup>2</sup> The term "designated contractors and consultants" means those persons or business organizations with whom the Board enters into contracts for services, whom the Board determines should be subject to the Code, and for which the contract contains a provision expressly incorporating this Code (in whole or in part). The Board

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equivalents, and dependents will either be subject to the Code, or impact the obligation of the Board member or staff under the Code. In summary, the Code will provide that –

- With certain exceptions, Board members and professional staff may not, while employed by the Board, owe or be owed any financial or other obligation to or by any former employer, business partner, publisher or client. Routine banking and similar commercial relationships, and various forms of deferred compensation are excluded from this prohibition.
- Neither members of the Board, nor their spouses, spousal equivalents, or dependents, may share in the profits of, or receive payments from, a public accounting firm, other than fixed continuing payments under standard retirement arrangements. With regard to Board members, this provision is specifically required by Section 101(e)(3) of the Act.
- Board members and staff may not have any financial interest in a public accounting firm, and are instructed to avoid investments that affect or reasonably create the appearance of affecting their independence or objectivity. Personal investments are not otherwise restricted.
- Board members and professional staff must annually disclose their holdings, and those of their spouses, spousal equivalents, and dependents, in securities of issuers. The disclosures must be filed with the Board's Ethics Officer. In addition, Board member investment disclosures will be made available to the public.
- Board members and professional staff are disqualified from participating in any Board function or activity if they (or their spouses, spousal equivalents, or dependents) hold any financial interest or other relationship that might affect or create the appearance of affecting his or her independence or objectivity. In those circumstances, the Code prescribes a disclosure and recusal process.
- Board members and staff are prohibited from disclosing any confidential, non-public information obtained by virtue of their positions with the Board and may not use such information for the financial gain of themselves or others.

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will maintain a list of designated contractors and consultants, which will be available to the public, and may contractually impose additional restrictions or limitations. Pursuant to Rule 3700, see PCAOB Release No. 2003-009, Board advisory group members must also comply with certain provisions of the Ethics Code.

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- Board members may not undertake any employment or other activity for compensation outside of service to the Board. Even if not for compensation, no Board member or staff may engage in any outside activity which interferes with his or her responsibilities to the Board or creates a reasonable appearance of a conflict of interest.
- Staff may undertake outside employment or other activity for compensation only if approved by the Board (or a Board designee, e.g., its Chief Administrative or Ethics Officers).
- Former Board members and professional staff are prohibited from participating in any decision that is reasonably likely to have a material effect on a former employer, business partner or client for one year from the date of appointment or hire. However, this prohibition applies only when the prior business relationship terminated within five years before joining the Board.
- Board members and professional staff are prohibited from practicing before the Board or the SEC, with respect to Board-related matters, for one year after leaving the Board and are permanently prohibited from participating in matters that they personally and substantially participated in while at the Board.
- Board members or staff must disclose any negotiations with a public accounting firm or issuer for prospective employment and recuse themselves from matters concerning that accounting firm or issuer.
- The Board will designate an Ethics Officer to oversee compliance with these rules and provide guidance to the Board and staff as necessary.
- The Code creates a mechanism for requesting and receiving a waiver of any provision, provided granting of the waiver would not otherwise hinder the interests or reputation of the Board. Waivers will be made available to public, subject to withholding information that would constitute an unwarranted invasion of personal privacy.
- The Code represents a condition of employment with the Board. Board members and all staff must annually certify compliance.

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### **Public Comment**

A Proposed Ethics Code was released for public comment on April 18, 2003 and the Board received eight written comment letters. In response to these comments, the Board has clarified and modified certain aspects of the initial proposal. Most importantly, the revisions to the original proposal would –

- Clarify that the Code's application to "designated contractors and consultants" will require a three-step process: first, there will have to be a contract for services; second, the Board (or its designate) will have to determine that the Code should be applied to the contractor, in whole or in part; and last, the contract will have to contain specific provisions incorporating those portions of this Code applicable to the contractor.
- Eliminate the definition of "immediate family" and clarify which provisions of the Code apply to a Board or staff member's spouse, spousal equivalent, and dependents.
- Impose the obligation upon Board members and professional staff to disclose their personal investments, and those of their spouses, spousal equivalents and dependents, in the securities of issuers.
- Expand the narrow list of sponsors who are permitted to pay for Board-related travel to include associations of governmental (federal, state or local) bodies and non-U.S. institutions equivalent to the permissible domestic sponsors.
- Create a "reasonable person" standard for Board members and professional staff to use to determine whether a financial relationship requires disclosure and disqualification.
- Clarify that, in the context of members of an advisory group,<sup>3/</sup> independence and objectivity are not *per se* impaired because the group member's employer, business client or partner is subject to the Board's direct or indirect oversight.
- Clarify that Board members and professional staff are not required to disqualify themselves from participating in making or developing broad

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<sup>3</sup> See PCAOB Release No. 2003-009, and PCAOB Rule 3700 (regarding advisory groups).

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policies or procedures which may have some effect on a former employer, business partner or client, so long as the policy or procedure affects all similarly situated people and organizations to the same degree.

- Define those circumstances which trigger (and do not trigger) the requirement for Board members and professional staff to disclose when they are "negotiating prospective employment" with a public accounting firm or issuer.<sup>4</sup>
- Add a restriction on former Board members and professional staff participating in a matter they personally and substantially participated in while at the Board.
- Extend indefinitely the restriction on former Board members and professional staff disclosing non-public Board information.
- Make publicly available information on waivers of the Ethics Code.

### **Adoption Procedures**

If adopted by the Board, the proposed rules will be submitted to the SEC for approval. Pursuant to Section 107 of the Act, Board rules do not take effect unless approved by the Commission.

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<sup>4</sup> When this disclosure is triggered, Board members and professional staff must also disqualify themselves from participating in decisions directly affecting the prospective employer.

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The PCAOB is a private-sector, non-profit corporation, created by the Sarbanes-Oxley Act of 2002, to oversee the audits 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.

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**APPENDIX**

**List of Proposed Sections within Ethics Code**

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| EC1 | Application of Code  |
| EC2 | Definitions <ul style="list-style-type: none"><li>(a) Reference to Rules of the Board</li><li>(b) Code</li><li>(c) Dependent</li><li>(d) Designated Contractors and Consultants</li><li>(e) Honoraria</li><li>(f) Practice</li><li>(g) Professional Staff or Professional Staff of the Board</li><li>(h) Staff or Staff of the Board</li></ul> |
| EC3 | General Principles   |
| EC4 | Financial and Employment Interests   |
| EC5 | Investments  |
| EC6 | Outside Activities   |
| EC7 | Gifts, Reimbursements, Honoraria and Other Things of Value   |
| EC8 | Disqualification   |



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EC9	Non-Public Information
EC10	Speaking for the Board
EC11	Ethics Officer
EC12	Post-Employment Restrictions
EC13	Waiver
EC14	Certification