

April 9, 2020

By Electronic Mail

The Honorable Walter J. Clayton
The Honorable Hester M. Peirce
The Honorable Elad L. Roisman
The Honorable Allison Herren Lee
US Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Dear Chairman Clayton and Commissioners Peirce, Roisman, and Lee:

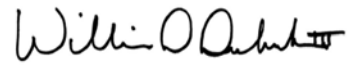
I am pleased to transmit to you a summary of the Public Company Accounting Oversight Board's (PCAOB) Office of Internal Oversight and Performance Assurance (IOPA) performance review, titled Ethics Program Redesign. The PCAOB Board formed IOPA to provide the Board, the Securities and Exchange Commission, and others assurance that the PCAOB is achieving the objectives of Title I of the Sarbanes-Oxley Act in an effective manner. IOPA conducted this review in conformance with the Institute of Internal Auditors' *International Standards for the Professional Practice of Internal Auditing*.

IOPA undertook this review to document, review, and evaluate the plan/redesign of the Ethics and Compliance program to offer a preliminary assessment of the program's adequacy and provide constructive feedback prior to implementation.

As the summary describes, IOPA concluded that the Chief Compliance Officer (CCO) has proposed a robust and comprehensive redesign plan. With the creation of the Office of Enterprise Risk Management (OERM) and hiring of seasoned risk professionals, the PCAOB has the opportunity and potential to implement an effective Ethics Program. IOPA proposed a number of recommendations that it believes will add value to the OERM Ethics Program redesign. We accept those recommendations and PCAOB management is working diligently to implement these improvements.

The Board intends to publish the summary on the PCAOB's public website on or about April 24, 2020. Please feel free to contact the Director of IOPA, Ryan Sack, at (202) 591-4165, or me if you have any questions or would like any additional information about the review.

Sincerely,

A handwritten signature in black ink that reads "William D. Duhnke III". The signature is written in a cursive style with a prominent "W" and "D".

William D. Duhnke III
Chairman

Enclosure: Ethics Program Redesign (IOPA-19-OA-04), dated November 2019

PERFORMANCE REVIEW

ETHICS PROGRAM REDESIGN **(19-OA-04)**

INTERNAL OVERSIGHT AND PERFORMANCE ASSURANCE **NOVEMBER 2019**

Background

In Q4 2018, the Board created a new Office of Enterprise Risk Management (OERM) in furtherance of the PCAOB's 2018 – 2022 Strategic Plan. In February 2019, the PCAOB hired its first Chief Risk Officer (CRO) to head the newly created office, and the Ethics Office was moved from the Office of the General Counsel (OGC) to OERM. In April 2019, the prior Ethics Officer retired from the PCAOB, and the CRO was designated as the Interim Ethics Officer until May 15, 2019, when the Board designated the newly hired Chief Compliance Officer (CCO) to be the Ethics Officer.

The CCO was tasked with developing a new, comprehensive compliance program for the PCAOB, which would complement her role and functions as the Board-designated PCAOB Ethics Officer.

Due to the deep structural changes anticipated by the CCO in redesigning the Ethics program, we determined that the performance review offering the greatest value to the organization would be to assess the Ethics Program plan/redesign and make preliminary recommendations to enhance the plan. In general, the redesign plan is to implement revised ethics policies, a new training regimen, and a new framework for assigning and documenting reported ethics concerns.

Objective and Scope

The purpose of our review was to document, review, and evaluate the staff's plan/redesign of the Ethics and Compliance Program to offer a preliminary assessment of the future program's adequacy and provide constructive feedback prior to implementation. After the CCO has implemented the program redesign, Internal Oversight and Performance Assurance (IOPA) will return to assess the execution of the program implementation and evaluate Ethics and Compliance operations.

As our review was an evaluation of a program plan/redesign that OERM has not yet implemented, we did not perform substantive testing. To accomplish our objective, we:

1. Interviewed the CCO and other PCAOB staff to identify and document roles and responsibilities, and to identify potential conflicts of interest or operational inefficiencies in the reporting structure.

2. Obtained and reviewed current and draft ethics policies.
3. Reviewed ethics and compliance training materials and activities, as well as planned changes to employee trainings and communications.
4. Reviewed and assessed ethics inquiry and investigation processes, as well as planned procedural changes.
5. Reviewed and assessed policies and practices related to the gathering and use of employee related-party data.

We conducted our review in conformance with the Institute of Internal Auditors' *International Standards for the Professional Practice of Internal Auditing*.

Summary Results and Conclusion

We found that the CCO has proposed a robust and comprehensive redesign plan. With the creation of OERM and hiring of seasoned risk professionals, the PCAOB has the opportunity and potential to implement an effective Ethics Program. The plans we reviewed should put OERM on the path to realize this potential, and our subsequent implementation review will determine whether the plan has been successfully accomplished. We offer the following recommendations that we believe will add value to the OERM Ethics Program redesign, and which are further described in the detailed section of this report:

Optimize the Ethics Program Governance Structure – At the time of our review, the CCO, who leads the Ethics Program, had a temporary *functional* reporting line to the PCAOB Chief of Staff. This was a safeguard implemented when the CRO assumed the acting position of Chief Administrative Officer (CAO) and removed herself from directing the day-to-day OERM operations. However, the CRO retained *administrative* authority over OERM (performance reviews, compensation determination, etc.).

We assert that the high importance of the Ethics Program's independence requires a strong governance structure, where the first and second lines of defense report to different Division/Office leaders. Our understanding is the Board considers the current reporting structure temporary, though the approach and timing of a long-term solution is not clear.

Establish a Process for Identifying Related Parties –

As OERM redesigns its Ethics Program, it has an opportunity to increase the PCAOB's ability to identify and avoid conflicts of interest with related parties. By identifying businesses where PCAOB employees involved in vendor selection or their immediate family members are owners, partners, or employees, Ethics can facilitate the compilation of a "potential sensitive vendor" list. Procurement can use this information to ensure the selection of new vendors (or RFP bidders) is free of influence from those with financial, business affiliation, or other interests in the selection outcome. Further, financial-holdings data that is already being collected should be accumulated in a single repository and reviewed to identify any potential conflicts of interest.

Increase Employee Feedback in the Annual Certification –

The annual employee ethics certification requires employees, designated contractors, and consultants to formally confirm their individual, continuing adherence with the PCAOB Ethics Code. However, the ethics certification has not historically asked employees if they are aware of any potential ethics issues within the larger organization.

While employees are able to voluntarily address ethics concerns through the Ethics hotline, failure to proactively ask for employee feedback during the annual certification process misses an opportunity for increased employee reflection and engagement.

Recommendations

1. We recommend the Chief of Staff consult with the Board to determine whether the CRO will lead the Office of Administration (OA) or OERM in the long term, and fill the vacated position at first opportunity.¹
2. As OERM contemplates its Ethics Program redesign, including a commercial off-the-shelf automated management system, it should
 - a. Consider whether gathering firm ownership/employment data to proactively identify related vendors can be efficiently achieved.
 - b. Determine whether it can accumulate and archive the existing financial-holdings disclosures in a single data repository that can enable subsequent analysis.
3. We recommend that OERM consider expanding its certification process by asking employees whether they are aware of circumstances that may be out of compliance with the PCAOB's Ethics Code.

OERM management provided responses indicating concurrence with our observations and a commitment to corrective actions that is responsive to our recommendations.

We thank all personnel who supported our review for their courtesy and cooperation throughout this assessment.

¹ Subsequent to the conclusion of IOPA's fieldwork, the Chief of Staff consulted with the Board on appointing a permanent CAO and a new CRO, if necessary. Following this consultation, the Chairman of the Board appointed the acting CAO to be the permanent CAO. Additionally, the Associate Director, OERM became the new CRO. These actions took effect on December 15, 2019.