FDC Date	State	City	Airport	FDC number	SIAP
12/08/99	TX	Longview	Gregg County	FDC 9/9602	NDB Rwy 13, AMDT 14...
12/09/99	NC	Siler City	Siler City Muni	FDC 9/9616	VOR OR GPS–A, AMDT 1A...
12/09/99	NC	Siler City	Siler City Muni	FDC 9/9620	NDB OR GPS Rwy 22, ORIG–A...
12/09/9	TX	Laredo	Laredo Intl	FDC 9/9609	VOR/DME OR TACAN OR GPS Rwy 32, AMDT 9A...
12/09/99	TX	Laredo	Laredo Intl	FDC 9/9610	VOR/DME OR TACAN OR GPS Rwy 14, AMDT 9...
12/09/99	TX	Laredo	Laredo Intl	FDC 9/9611	LOC BC Rwy 35L, AMDT 1...
12/13/99	LA	Slidell	Slidell	FDC 9/9672	VOR/DME OR GPS Rwy 18, AMDT 3A...
12/13/99	MS	Aberdeen Amory	Aberdeen/Monroe County	FDC 9/9661	VOR OR GPS Rwy 18, AMDT 6A...
12/14/99	AK	Homer	Homer	FDC 9/9697	GPS Rwy 3, ORIG–A...
12/14/99	IL	Chicago	Chicago-O'Hare Intl	FDC 9/9712	ILS Rwy 9L, AMDT 6A...
12/14/99	MD	Cumberland	Greater Cumberland Regional	FDC 9/9710	LOC/DME Rwy 23, AMDT 5D...
12/14/99	MD	Cumberland	Greater Cumberland Regional	FDC 9/9711	LOC–A AMDT 3C...
12/14/99	TN	Nashville	Nashville Intl	FDC 9/9716	ILS Rwy 2R (CAT I, II, III) AMDT 5A...
12/14/99	TX	Midland	Midland Intl	FDC 9/9706	LOC BC Rwy 28, AMDT 12A... This Replaces FDC 9/9393
12/15/99	FL	Fort Pierce	St. Lucie County Intl	FDC 9/9753	GPS Rwy 9, ORIG–A...
12/15/99	NC	Albemarle	Stanly County	FDC 9/9741	NDB OR GPS Rwy 22L, ORIG–C...
12/15/99	NC	Albemarle	Stanly County	FDC 9/9742	GPS Rwy 4R, ORIG–B...
12/15/99	NC	Albemarle	Stanly County	FDC 9/9743	ILS Rwy 22L, ORIG–A...
12/15/99	TX	Gainesville	Gainesville Muni	FDC 9/9774	NDB Rwy 7, AMDT 8... This Replaces FDC 9/9274.
12/15/99	TX	Greenville	Greenville/Majors	FDC 9/9775	NDB OR GPS Rwy 17, AMDT 5...
12/15/99	WY	Casper	Natrona County Intl	FDC 9/9744	ILS Rwy 3, AMDT 5...
12/20/99	TX	Gainesville	Gainesville Muni	FDC 9/9923	GPS Rwy 17, ORIG... This Replaces FDC 9/9275.
12/21/99	NE	North Platte	North Platte Regional Airport Lee Bird Field.	FDC 9/9961	NDB OR GPS Rwy 30R, AMDT 3...
12/21/99	NE	North Platte	North Platte Regional Airport Lee Bird Field.	FDC 9/9962	ILS Rwy 30R, AMDT 5B...
12/21/99	TX	Midland	Midland Intl	FDC 9/9963	VOR/DME OR TACAN Rwy 34L, AMDT 9A... This Replaces FDC NOTAM 9/9392.

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SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 210, 228, 229, and 240

[Release No. 34–42266; File No. S7–22–99]

RIN 3235–AH83

Audit Committee Disclosure

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Securities and Exchange Commission is adopting new rules and amendments to its current rules to require that companies' independent auditors review the companies' financial information prior to the companies filing their Quarterly Reports on Form 10–Q or Form 10–QSB with the Commission, and to require that companies include in their proxy statements certain disclosures about their audit committees and reports from their audit committees containing certain disclosures. The rules are designed to improve disclosure related to the functioning of corporate audit committees and to enhance the reliability and credibility of financial statements of public companies.

DATES: *Effective Date:* January 31, 2000.

Compliance Dates: Registrants must obtain reviews of interim financial information by their independent auditors starting with their Forms 10–Q or 10–QSB to be filed for fiscal quarters ending on or after March 15, 2000. Registrants must comply with the new proxy and information disclosure requirements (*e.g.*, the requirement to include a report of their audit committee in their proxy statements, provide disclosures regarding the independence of their audit committee members, and attach a copy of the audit committee's charter) for all proxy and information statements relating to votes of shareholders occurring after December 15, 2000. Companies who become subject to Item 302(a) of Regulation S–K as a result of today's amendments must comply with its requirements after December 15, 2000. Registrants voluntarily may comply with any of the new requirements prior to the compliance dates.

FOR FURTHER INFORMATION CONTACT: Mark Borges, Attorney-Adviser, Division of Corporation Finance (202–942–2900), Meridith Mitchell, Senior Counselor, Office of the General Counsel (202–942–0900), or W. Scott Bayless, Associate Chief Accountant, or

Robert E. Burns, Chief Counsel, Office of the Chief Accountant (202–942–4400).

SUPPLEMENTARY INFORMATION: The Commission is adopting amendments to Rule 10–01 of Regulation S–X,[1] Item 310 of Regulation S–B,[2] Item 7 of Schedule 14A [3] under the Securities Exchange Act of 1934 (the ''Exchange Act''),[4] and Item 302 of Regulation S–K.[5] Additionally, the Commission is adopting new Item 306 of Regulation S–K[6] and Item 306 of Regulation S–B.[7]

I. Executive Summary

We are adopting new rules and amendments to current rules to improve disclosure relating to the functioning of corporate audit committees and to enhance the reliability and credibility of financial statements of public companies.[8] As more fully described in the Proposing Release, the new rules and amendments are based in large measure on recommendations made by the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees (the ''Blue Ribbon Committee'').[9] The new rules and amendments have been adopted in most respects as proposed, with modifications discussed below.

Audit committees play a critical role in the financial reporting system by overseeing and monitoring management's and the independent auditors' participation in the financial reporting process. We have seen a number of significant changes in our markets, such as technological developments and increasing pressure on companies to meet earnings expectations,[10] that make it ever more important for the financial reporting process to remain disciplined and credible.[11] We believe that additional disclosures about a company's audit committee and its interaction with the company's auditors and management will promote investor confidence in the integrity of the financial reporting process. In addition, increasing the level of scrutiny by independent auditors of companies' quarterly financial statements should lead to fewer year-end adjustments, and, therefore, more reliable financial information about companies throughout the reporting year.

Accordingly, the new rules and amendments:

- Require that companies' independent auditors review the financial information included in the companies' Quarterly Reports on Form 10–Q or 10–QSB prior to the companies filing such reports with the Commission (see Section III.A below);
- Extend the requirements of Item 302(a) of Regulation S–K (requiring at fiscal year end appropriate reconciliations and descriptions of any adjustments to the quarterly information previously reported in a Form 10–Q for any quarter) [12] to a wider range of companies (see Section III.A below);
- Require that companies include reports of their audit committees in their proxy statements;[13] in the report, the audit committee must state whether the audit committee has: (i) Reviewed and discussed the audited financial statements with management; (ii) discussed with the independent auditors the matters required to be discussed by Statement on Auditing Standards No. 61,[14] as may be modified or supplemented; and (iii) received from the auditors disclosures regarding the auditors' independence required by Independence Standards Board Standard No. 1,[15] as may be modified or supplemented, and discussed with the auditors the auditors' independence (see Section III.B below);
- Require that the report of the audit committee also include a statement by the audit committee whether, based on the review and discussions noted above, the audit committee recommended to the Board of Directors that the audited financial statements be included in the company's Annual Report on Form 10–K or 10–KSB (as applicable) for the last fiscal year for filing with the Commission (see Section III.B below);
- Require that companies disclose in their proxy statements whether their Board of Directors has adopted a written charter for the audit committee, and if so, include a copy of the charter as an appendix to the company's proxy statements at least once every three years (see Section III.C below);
- Require that companies, including small business issuers,[16] whose securities are quoted on Nasdaq or listed on the American Stock Exchange (''AMEX'') or New York Stock Exchange (''NYSE''), disclose in their proxy statements whether the audit committee members are ''independent'' as defined in the applicable listing standards,[17] and disclose certain information regarding any director on the audit committee who is not ''independent''(see Section III.D below); require that companies, including small business issuers, whose securities are not quoted on Nasdaq or listed on the AMEX or NYSE disclose in their proxy statements whether, if they have an audit committee, the members are ''independent,'' as defined in the NASD's, AMEX's or NYSE's listing standards, and which definition was used (see Section III.D below); and
- Provide ''safe harbors'' for the new proxy statement disclosures to protect companies and their directors from certain liabilities under the federal securities laws (see Section III.E below).

To provide companies with the opportunity to evaluate their compliance with the revised listing standards of the NASD, AMEX, and NYSE and to prepare for the new disclosure requirements, we are providing transition periods for compliance with the new requirements (see Section V below).

II. Background

As discussed in the Proposing Release, given the changes in our markets, such as the increasing number of investors entering our markets and changes in the way and speed with which investors receive information, it is vitally important for investors to remain confident that they are receiving the highest quality financial reporting. The demand for reliable financial information appears to be at an all time high, as technology makes information

[1] 17 CFR 210.10–01.

[2] 17 CFR 228.310.

[3] 17 CFR 240.14a–101.

[4] 15 U.S.C. § 78a *et seq.*

[5] 17 CFR 229.302.

[6] 17 CFR 229.306.

[7] 17 CFR 228.306.

[8] The new rules and amendments were proposed in Exchange Act Release No. 41987 (Oct. 7, 1999) [64 FR 55648] (the ''Proposing Release'').

[9] *See* Report and Recommendations of the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees (1999) (the ''Blue Ribbon Report''). The Blue Ribbon Report is available on the internet at http://www.nasd.com and http://www.nyse.com.

[10] *See, e.g.,* Jack Ciesielski, Editorial, *More Second-Guessing: Markets Need Better Disclosure of Earnings Management,* Barrons, Aug., 24, 1998, at 47.

[11] The Commission recently filed 30 enforcement actions against 68 individuals and companies for fraud and related misconduct in the accounting, reporting, and disclosure of financial results by 15 different public companies. *See* SEC Press Release 99–124 (Sept. 28, 1999).

[12] 17 CFR 229.302(a).

[13] References in this release to proxy statements also include information statements.

[14] *See* Codification of Statements on Auditing Standards, AU § 380 (''SAS 61'').

[15] Independence Standards Board Standard No. 1, *Independence Discussions with Audit Committees* (''ISB Standard No. 1''). A copy of ISB Standard No. 1 can be obtained at www.cpaindependence.org.

[16] ''Small business issuer'' is defined in Item 10(a)(1) of Regulation S–B, 17 CFR 228.10(a)(1), as a company with less than $25 million in revenues and market capitalization.

[17] The listing standrds of the National Association of Securities Dealers (''NASD''), AMEX and NYSE are available on their websites at: http://www.nasd.com, http://www.amex.com, and http://www.nyse.com, respectively. *See infra* note 27 regarding recent changes to the listing standards of the NASD, AMEX, and NYSE.

available to more people more quickly. The new dynamics of our capital markets have presented companies with an increasingly complex set of challenges. One challenge is that companies are under increasing pressure to meet earnings expectations.[18] We have become increasingly concerned about inappropriate ''earnings management,'' the practice of distorting the true financial performance of the company.[19]

The changes in our markets and the increasing pressures on companies to maintain positive earnings trends have highlighted the importance of strong and effective audit committees. Effective oversight of the financial reporting process is fundamental to preserving the integrity of our markets. Audit committees play a critical role in the financial reporting system by overseeing and monitoring management's and the independent auditors' participation in the financial reporting process. Audit committees can, and should, be the corporate participant best able to perform that oversight function.

As discussed more fully in the Proposing Release, since the early 1940s, the Commission, along with the auditing and corporate communities, has had a continuing interest in promoting effective and independent audit committees. Most recently, the NYSE and NASD sponsored the Blue Ribbon Committee in response to ''an increasing sense of urgency surrounding the need for responsible financial reporting given the market's increasing focus on corporate earnings and a long and powerful bull market.''[20] The new rules and amendments affirm what have long been considered sound practice and good policy within the accounting and corporate communities.[21]

While almost all of the commenters that provided comment letters on the Proposing Release[22] supported our goals of improving disclosure about audit committees and enhancing the reliability and credibility of financial statements, many commenters suggested alternative approaches to achieving those goals. Some commenters believed that we should impose more rigorous requirements.[23] Other commenters recommended that we not adopt certain aspects of the proposals. In this regard, the concern most frequently expressed was that as a result of the new requirements to provide certain disclosures in a report, audit committees may be exposed to additional liability, and that consequently it may be difficult for companies to find qualified people to serve on audit committees.[24]

It is not our intention to subject audit committee members to increased liability. We addressed concerns about liability by modifying our initial proposals from the Blue Ribbon Committee's recommendations and by providing safe harbor protections. Nevertheless, we appreciate that many commenters continue to be concerned about the audit committee report generally, and specifically the requirement that the audit committee state whether anything has come to the attention of the members of the audit committee that caused the audit committee to believe that the audited financial statements included in the company's Annual Report on Form 10–K or 10–KSB contain an untrue statement of material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which they were made, not misleading.

In response, we have modified that disclosure item, which was the subject of most of the commentary. We are adopting, instead, one of the other alternatives proposed—the audit committee must state whether, based on the review and discussion of the audited financial statements with management and discussions with the independent auditors, the audit committee recommended to the Board that the audited financial statements be included in the company's Annual Report on Form 10–K or 10–KSB (as applicable) for the last fiscal year for filing with the Commission. As we discussed in the Proposing Release, we do not believe that improved disclosure about the audit committee and increased involvement by the audit committee should result in increased exposure to liability. Consequently, we believe that this modification, together with the safe harbors, should further alleviate concerns about increased liability exposure, while promoting our goal of improving the financial reporting process.

Some commenters expressed concern about applying the new requirements to small businesses, particularly the interim financial review requirement. We have considered those comments carefully. We think that improvements in the financial reporting process for companies of all sizes is important for promoting investor confidence in our markets.[25] In this regard, because we have seen instances of financial fraud at small companies as well as at large companies,[26] we think that improving disclosures about the audit committees of small and large companies is important. As discussed in the Proposing Release, interim financial information generally may include more estimates than annual financial statements, but interim financial statements have never been subject to the discipline provided by having auditors associated with these statements on a timely basis. Investors, however, rely on and react quickly to quarterly results of companies, large and small. Accordingly, we believe that it is appropriate to require small business issuers to obtain reviews of interim financial information. As discussed below, however, small business issuers are not included in the expanded group of issuers subject to Item 302(a) disclosure requirements. In addition, we think that the transition period should help small businesses prepare for and adapt to the new requirements.

The Blue Ribbon Committee also made recommendations that call for action by the NASD, the NYSE, and the AICPA. In response, the NASD and NYSE proposed, and the Commission

[18] *See, e.g.,* Carol J. Loomis *et al., Lies, Damned Lies, and Managed Earnings,* Fortune, Aug. 2, 1999, at 74; Thor Valdmanis, *Accounting Abracadabra,* USA Today, Aug. 11, 1998, at 1B; Bernard Condon, *Pick a Number, Any Number,* Forbes, Mar. 23, 1998, at 124; Justin Fox & Rajiv Rao, *Learn to Play the Earnings Game,* Fortune, Mar. 31, 1997, at 76.

[19] *See, e.g.,* Arthur Levitt, Chairman, SEC, Address to the NYU Center for Law and Business (Sept. 28, 1998). A copy of this speech is available on the SEC's website at www.sec.gov.

[20] Blue Ribbon Report, *supra* note 9, at 17.

[21] *See* Advisory Panel on Auditor Independence (''Kirk Panel''), *Strengthening the Professionalism of the Independent Auditor,* Report by the Oversight Board of the SEC Practice Section, American Institute of Certified Public Accountants (''AICPA'') (Sept. 13, 1994) (the ''Kirk Panel Report''); *see also* Report of the National Commission on Fraudulent Financial Reporting (Oct. 1987) (the ''Treadway Report'').

[22] You may read and copy the comment letters in our Public Reference Room at 450 Fifth Street, N.W., Washington, D.C. 20549. Ask for File No. S7–22–99. You may view the comment letters that were submitted by electronic mail at the Commission's web site: www.sec.gov.

[23] *See, e.g.,* Letter dated November 8, 1999 from Sarah A.B. Teslik, Executive Director, Council of Institutional Investors; Letter dated October 14, 1999 from Robert B. Hodes, Willkie Farr & Gallagher.

[24] *See, e.g.,* Letter dated November 29, 1999 from Stephanie B. Mudick, General Counsel—Corporate Law, Citigroup Inc. (''Citigroup Letter''); Letter dated November 22, 1999 from Michael L. Conley, Executive Vice President and CFO, McDonald's Corporation.

[25] *See, e.g.,* Letter dated November 19, 1999 from the New York State Bar Association, Committee on Securities Regulation (''NYS Bar Letter'') and Letter dated November 17, 1999 from KPMG LLP (''KPMG Letter'') supporting application of the amendments and new rules to companies of all sizes.

[26] *See supra* note 11; *see also* Beasley, Carcello, and Hermanson, Fraudulent Financial Reporting: 1987–1997, An Analysis of U.S. Public Companies (Mar. 1999) (study commissioned by the Committee of Sponsoring Organizations of the Treadway Commission) (the ''COSO Report'').

approved, changes to their listing standards,[27] and the Auditing Standards Board (''ASB'') recently proposed amendments [28] to SAS 61 [29] and SAS 71.[30]

III. Discussion of New Rules and Amendments

A. Pre-Filing Review of Quarterly Financial Statements; Item 302(a)

We are adopting, as proposed, amendments to Rule 10–01(d) of Regulation S–X and Item 310(b) of Regulation S–B to require that a company's interim financial statements be reviewed by an independent public accountant prior to the company filing its Form 10–Q or 10–QSB with the Commission.[31] The amendments would require that independent auditors follow ''professional standards and procedures for conducting such reviews, as established by generally accepted auditing standards, as may be modified or supplemented by the Commission.'' Under current auditing standards, this means that the auditors would be required to follow the procedures set forth in SAS 71, or such other auditing standards that may in time modify, supplement, or replace SAS 71.

As noted above, we believe that more discipline is needed for the quarterly financial reporting process.[32] We believe that the reviews required will facilitate early identification and resolution of material accounting and reporting issues because the auditors will be involved earlier in the year. Early involvement of the auditors should reduce the likelihood of restatements or other year-end adjustments and enhance the reliability of financial information. In addition, as a result of changes in the markets, companies may be experiencing increasing pressure to ''manage'' interim financial results. Inappropriate earnings management could be deterred by imposing more discipline on the process of preparing interim financial information before filing such information with the Commission.

Many commenters supported the interim review requirement.[33] Several commenters expressed concern, however, about the cost of obtaining interim reviews, particularly for small business issuers.[34] As discussed above, we believe that improving the interim reporting process is important for companies of all sizes. As noted in the Proposing Release, we understand that the five largest U.S. accounting firms and other firms have policies to require that their clients have reviews of quarterly financial statements as a condition to acceptance of the audit.[35] Consequently, those firms already have implemented the new requirement for the companies that are audited by those firms.

In the Proposing Release, we solicited comment on whether, in light of the proposal to require interim reviews, we should require all companies to comply with Item 302(a) of Regulation S–K. Currently, under Item 302(a) of Regulation S–K, larger, more widely-held companies [36] supplement their annual financial information with disclosures of selected quarterly financial data. Item 302(a) requires appropriate reconciliations and descriptions of any adjustments to the quarterly information previously reported in a Form 10–Q for any quarter. The selected financial data must be reviewed by the independent auditors in accordance with SAS 71, but the review can occur at the end of the year and as part of the audit of the annual financial statements. We are amending Item 302(a) to extend the requirements to all companies [37] (except small business issuers filing on small business forms) that have securities registered under Sections 12(b) [38] or 12(g) [39] of the Exchange Act regardless of the size of the company or public float.[40]

Regulation S–B does not require small business issuers to provide Item 302(a) type disclosures. Today's amendments continue to exclude small business issuers filing under Regulation S–B from

[27] *See* Order Approving Proposed Rule Change by the NASD, Exchange Act Release 42231, File No. SR–NASD–99–48; Order Approving Proposed Rule Change by the NYSE, Exchange Act Release No. 42233, File No. SR–NYSE–99–39. While the Blue Ribbon Committee's recommendations were directed to the NYSE and the NASD, the AMEX proposed, and the Commission approved, rule changes to AMEX's listing standards. *See* Order Approving Proposed Rule Change by the AMEX, Exchange Act Release No. 42232, File No. SR–Amex–99–38.

[28] *See* Exposure Draft for Proposed Statement on Auditing Standards: Amendments to Statements on Auditing Standard No. 61, Communication with Audit Committees and Statements on Auditing Standard No. 71, Interim Financial Information (Oct. 1, 1999) (''ASB Exposure Draft''). A copy of the ASB Exposure Draft can be obtained at www.aicpa.org/members/div/auditstd/drafts.htm.

[29] SAS 61 requires independent auditors to communicate certain matters related to the conduct of an audit to those who have responsibility for oversight of the financial reporting process, specifically the audit committee. Among the matters to be communicated to the audit committee are: (1) Methods used to account for significant unusual transactions; (2) the effect of significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus; (3) the process used by management in formulating particularly sensitive accounting estimates and the basis for the auditor's conclusions regarding the reasonableness of those estimates; and (4) disagreements with management over the application of accounting principles, the basis for management's accounting estimates, and the disclosures in the financial statements.

[30] *See* Codification of Statements on Auditing Standards, AU § 722. SAS 71 provides guidance to independent accountants on performing reviews of interim financial information.

[31] In the Proposing Release, we solicited comment on whether to require companies to disclose whether their quarterly financial statements have been reviewed by independent auditors. We are not adopting that requirement, but are retaining the current requirement of Rule 10–01(d) of Regulation S–X, 17 CFR 210.10–01(d), that if a company discloses that an independent auditor has performed a review of interim financial information, it must file a copy of the auditor's report. A conforming change to Item 310(b) has been made as proposed.

[32] In 1989, the Commission issued a concept release on whether it should propose amendments to its rules to require more involvement of the independent accountant in the preparation of interim financial information. *See* Exchange Act Release No. 26949 (June 20, 1989) [54 FR 27023]. The Treadway Commission recommended that the SEC require independent public accountants to review quarterly financial data before a company releases it to the public. Treadway Report, *supra* note 21, at 53.

[33] *See, e.g.,* Letter dated November 29, 1999 from The Business Roundtable (''We believe that a requirement for such a review would not impose a substantial burden and would help to improve the investor's comfort with interim statements''); Letter dated November 23, 1999 from Mark Wovsaniker, Vice President—Accounting Policy, America Online Incorporated (''To promote the accuracy and the high quality of the quarterly results, the auditor's regular involvement throughout the year, not just once at the end of each year, is necessary''); Letter dated November 22, 1999 from the Association for Investment Management and Research—Advocacy Advisory Committee (''AIMR Letter'') (''[The proposal] will require auditor involvement throughout the year, which should help mitigate earnings management, as well as reduce the likelihood of restatements or other year-end adjustments'').

[34] *See, e.g.,* Letter dated December 3, 1999 from the American Bar Association—Section of Business Law (''ABA Letter'').

[35] One firm's policy apparently applies only to clients filing selected quarterly financial data under Item 302(a) of Regulation S–K, 17 CFR 229.302(a).

[36] Prior to today's amendments, Item 302(a) required registrants to provide Item 302(a) information if the registrant met certain tests, but not limited to: (1) Two of the three following requirements: (a) Shares outstanding have a market value of at least $2.5 million; (b) the minimum bid price is at least $5 per share; or (c) the registrant has at least $2.5 million of capital, surplus, and undivided profits; and (2) the registrant and its subsidiaries: (a) Have had net income after taxes but before extraordinary items and the cumulative effect of a change in accounting of at least $250,000 for each of the last three fiscal year; or (b) had total assets of at least $200 million for the last fiscal year end.

[37] *See, e.g.,* KPMG Letter, *supra* note 25, supporting this amendment.

[38] 15 U.S.C. § 78*l*(b).

[39] 15 U.S.C. § 78*l*(g).

[40] We are eliminating the requirement for large, widely-traded insurance companies, which file periodic reports solely pursuant to Section 15(d) of the Exchange Act, to provide Item 302(a) information. It is noted in this regard that other types of issuers reporting solely pursuant to Section 15(d) are not required to provide Item 302(a) information. The Item 302(a) amendments will accord insurance companies the same treatment under Item 302(a) as other issuers that report solely pursuant to Section 15(d).

those disclosure requirements,[41] but we will continue to consider whether and how such requirements should apply to small business issuers.

We believe that the amendments to Item 302(a) are consistent with the new requirement to obtain interim reviews. Both new measures should add discipline to the process of preparing and reporting quarterly financial information. Both should also encourage early identification of accounting issues and resolution of those issues before they must be subject to an auditor's review or a ''reconciling'' disclosure under Item 302(a)(2). Because the information to be disclosed should be readily available from each company's Form 10–Q filings, no additional audit or review costs will be imposed by the amendments to Item 302(a).

B. The Audit Committee Report

We are adopting new Item 306 of Regulations S–K and S–B and Item 7(e)(3) of Schedule 14A that require the audit committee to provide a report in the company's proxy statement. The required disclosure will help inform shareholders of the audit committee's oversight with respect to financial reporting, and underscore the importance of that role.

Many commenters were concerned that a report by the audit committee that indicates whether various discussions have occurred would expose the audit committee members to increased scrutiny and liability.[42] We do not believe that will be the case. Under state corporation law, the more informed the audit committee becomes through its discussions with management and the auditors, the more likely that the ''business judgment rule'' will apply and provide broad protection.[43] Those discussions should serve to strengthen the ''information and reporting system'' that should be in place.[44] Adherence to a sound process should result in less, not more, exposure to liability.[45]

Accordingly, we are adopting, as proposed, the requirement that the audit committee disclose whether the audit committee has reviewed and discussed the audited financial statements with management and discussed certain matters with the independent auditors.[46] Under paragraphs (a)(1), (a)(2), and (a)(3) of Item 306 (paragraph (a)(4) is discussed separately, below), audit committees must state whether:

(1) The audit committee has reviewed[47] and discussed the audited financial statements with management;

(2) The audit committee has discussed with the independent auditors the matters required to be discussed by SAS 61, as may be modified or supplemented;[48] and

(3) The audit committee has received the written disclosures and the letter from the independent auditors required by ISB Standard No. 1, as may be modified or supplemented, and has discussed with the auditors the auditors' independence.

If the company does not have an audit committee, the board committee tasked with similar responsibilities, or the full board of directors, would be responsible for the disclosure.

The disclosure required by paragraph (a)(3) relates to written disclosures, a letter from the independent auditors, and discussions between the audit committee and the independent auditors required by ISB Standard No. 1. The Commission has long recognized the importance of auditors being independent from their audit clients.[49] Public confidence in the reliability of a company's financial statements depends on investors perceiving the company's auditors as being independent from the company.

As noted above, paragraph (a)(4) was the subject of the most criticism. Commenters expressed concern about increased liability exposure, which they believed may result in qualified audit committee members resigning or companies having difficulty recruiting qualified members.[50] Some commenters, on the other hand, were skeptical that there would be increased liability exposure.[51]

Because of concerns about liability, we did not propose the disclosure requirement recommended by the Blue Ribbon Committee,[52] but instead proposed that the audit committee indicate whether, based on its discussions with management and the auditors, its members became aware of material misstatements or omissions in the financial statements. As discussed in the Proposing Release, we did not intend, nor do we believe, that the proposed disclosure about the audit committee and increased involvement by the audit committee would result in increased exposure to liability. Because commenters continued to be concerned, however, we are adopting an alternative contained in the Proposing Release. We believe that the revised language, together with the safe harbors, addresses those concerns.

As adopted, new paragraph (a)(4) requires the audit committee to state whether, based on the review and discussions referred to in paragraphs (a)(1) through (a)(3), it recommended to the Board of Directors that the financial statements be included in the Annual Report on Form 10–K or 10–KSB for the last fiscal year for filing with the Commission.[53] Because the new

[41] *See* Letter dated November 29, 1999 from Ernst & Young recommending that the criteria for Item 302(a) compliance be based on a company's market capitalization, such as above $25 million.

[42] *See, e.g.,* Letter dated November 24, 1999 from Tommy Chisholm, Secretary, Southern Company; Citigroup Letter, *supra* note 24. *But see* Letter dated November 26, 1999 from Peter C. Clapman, Senior Vice President and Chief Counsel, Investments, Teachers Insurance and Annuity Association College Retirement Equities Fund (''TIAA-CREF Letter'').

[43] *See* 1 American Law Institute, *Principles of Corporate Governance: Analysis and Recommendations* 134–98 (1994); *In re Caremark Int'l Inc. Derivative Litig.,* 698 A.2d 959, 967–70 (Del. Ch. 1996).

[44] *Caremark,* 698 A.2d at 970 (boards must assure ''themselves that information and reporting systems exist in the organization that are reasonably designed to provide to senior management and to the board itself timely, accurate information sufficient to allow management and the board, each within its scope, to reach informed judgments concerning both the corporation's compliance with law and its business performance'').

[45] *See generally* Report of the Public Oversight Board (''POB''), ''Directors, Management, and Auditors: Allies in Protecting Shareholder Interests,'' in which the POB discusses, among other things, a recommendation of the Kirk Panel to require audit committees to discuss with management and the auditors the quality of the accounting principles and judgments used in preparing financial statements. The POB notes its belief that compliance with that recommendation would not increase the exposure of board members to litigation because, among other things, the procedures will reduce the possibility that the financial statements are in fact misleading, thereby reducing the danger of finding directors at fault, and the additional steps taken should be persuasive in convincing courts and juries that the financial statements were prepared with care.

[46] At least in some measure, these discussions are already prescribed by the auditing literature. *See* SAS 61. *See, e.g.,* Letter dated November 29, 1999 from America's Community Bankers and Letter dated November 22, 1999 from the Massachusetts Financial Services Company supporting the requirements of paragraphs (a)(1), (2) and (3).

[47] We recognized that the auditing literature defines the term ''review'' to include a particular set of required procedures. *See* SAS 71. In using the term ''reviewed'' in the new disclosure requirement, we are not suggesting that the audit committee members can or should follow the procedures required of auditors performing reviews of interim financial statements.

[48] *See* ASB Exposure Draft, *supra* note 28.

[49] The federal securities law recognize the importance of independent auditors. *See, e.g.,* Items 25 and 26 of Schedule A of the Securities Act and Sections 12(b)(1)(J) and 13(a)(2) of the Exchange Act, 15 U.S.C. 78*l*(b)(1)(J) and 78m(a)(2).

[50] See *supra* note 24.

[51] *See, e.g.,* TIAA–CREF Letter, *supra* note 42.

[52] The Blue Ribbon Committee recommended that the audit committee state that, in reliance on the review and discussions with management and the auditors, the audit committee ''believes that the company's financial statements are fairly presented in conformity with Generally Accepted Accounting Principles (GAAP) in all material respects.'' Blue Ribbon Report, *supra* note 9, at 35.

[53] For closed-end investment companies, paragraph (a)(4) clarifies that this requirement applies to financial statements included in a fund's annual report to shareholders required by Section 30(e) of the Investment Company Act of 1940 and

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language in paragraph (a)(4) focuses on the annual audited financial statements and the filing of those financial statements with the Commission, we believe that this requirement will provide investors with a better understanding of the audit committee's oversight role in the financial reporting process. The audit committee's recommendation that the financial statements be used in Commission filings already is implicit in, and is consistent with, board members signing the company's Annual Report on Form 10–K or 10–KSB.[54] Further, several commenters preferred this alternative.[55]

In addition, in performing its oversight function, the audit committee likely will be relying on advice and information that it receives in its discussions with management and the independent auditors. Accordingly, the text of the new requirement acknowledges that the audit committee had such discussions with management and the auditors, and, based on those discussions, made decisions about the financial statements and the filing of the company's Form 10–K or 10–KSB. This approach is consistent with state corporation law that permits board members to rely on the representations of management and the options of experts retained by the corporation when reaching business judgments.[56] The Blue Ribbon Committee noted the ''impracticability of having the audit committee do more than rely upon the information it receives, questions, and assesses in making this disclosure.''[57]

We are adopting, as proposed, the requirement that the new disclosure appear over the printed names of each member of the audit committee.[58] This requirement will emphasize for shareholders the importance of the audit committee's oversight role in the financial reporting process.

The disclosures are required in the company's proxy statement because they could have a direct bearing on shareholders' voting decisions, and because the proxy statement is actually delivered to shareholders and is accessible on the SEC's web site. Companies must provide the disclosure only in a proxy statement relating to an annual meeting of shareholders at which directors are to be elected (or special meeting or written consents in lieu of such meeting). The disclosure needs to be provided only one time during the year (*e.g.*, in a proxy statement for an annual meeting at which directors are to be elected, but not in proxy solicitation material used in a subsequent election contest during that same year).

C. Audit Committee Charters

We are adopting, as proposed, the requirement that companies disclose in their proxy statements whether their audit committee is governed by a charter, and if so, include a copy of the charter as an appendix to the proxy statement at least once every three years. The requirement appears in new paragraph (e)(3) under Item 7 of Schedule 14A. The new disclosure regarding audit committees' charters should help shareholders assess the role and responsibilities of the audit committee.

We believe that audit committees that have their responsibilities set forth in a written charter are more likely to play an effective role in overseeing the company's financial reports. The amendments, however, will not require companies to adopt audit committee charters, or dictate the content of the charter if one is adopted.[59]

Several commenters expressed concern that the requirement to attach the charter would result in boilerplate charters.[60] We believe that it is useful for shareholders to know about the responsibilities and the duties of audit committees,[61] and while it is inevitable that some of the same provisions will appear in charters of different audit committees, we encourage companies to tailor the charters to their specific circumstances.

Consistent with some of the comments regarding the audit committee report, some commenters recommended that the charter be attached to the Form 10–K instead of the proxy statement because of concerns about expanding the length of the proxy statement.[62] We believe that information about the responsibilities and the duties of audit committees is most relevant to shareholders when they are electing directors and reviewing their performance. Accordingly, we have determined to require, as proposed, that the charter be attached to the proxy statement every three years.

D. Disclosure About ''Independence'' of Audit Committee Members

As early as 1940, the Commission encouraged the use of audit committees composed of independent directors. As the Commission staff stated in a report to Congress in 1978, ''[i]f the [audit] committee has members with vested interests related to those of management, the audit committee probably cannot function effectively. In some instances this may be worse than having no audit committee at all by creating the appearance of an effective

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rule 30d–1. These reports must be filed with the Commission pursuant to Rule 30b2–1, 17 CFR 270.30b2–1, under the Investment Company Act of 1940. Commenters disagreed about whether closed-end funds be excluded altogether from the new proxy statement disclosure requirements. *See, e.g.,* ABA Letter, *supra* note 34; Letter dated November 29, 1999 from Stuart M. Strauss, Morgan Stanley Dean Witter; Letter dated November 29, 1999 from Arthur Andersen LLP; Letter dated November 3, 1999 from the Investment Company Institute. We have concluded, however, that the application of these requirements to closed-end funds is warranted because of the critical role that audit committees play in overseeing the financial reporting process.

[54] The signature requirement is described in General Instruction D of Form 10–K and General Instruction C of Form 10–KSB. The Commission amended the signature requirements for Form 10–K in 1980 in order to ''enhance director awareness of and participation in the preparation of the Form 10–K information.'' *See* Securities Act Release No. 6176 (Jan. 15, 1980) [45 FR 5972].

[55] *See, e.g.,* Letter dated December 1, 1999 from Ira M. Millstein, Weil Gotshal & Manges LLP, and John C. Whitehead. Messrs. Millstein and Whitehead were co-chairmen of the Blue Ribbon Committee; Letter dated November 29, 1999 from Deloitte & Touche LLP; Letter dated November 29, 1999 from James E. Kelly, General Counsel, Dime Bancorp, Inc.; Letter dated November 23, 1999 from Michael A. Rocca, Senior Vice President, Chief Financial Officer, Mallinckrodt Inc. (''This type of report better describes the audit committee's oversight role * * *. Moreover, in our view this alternative language would create a less significant litigation risk to audit committees''); NYS Bar Letter, *supra* note 25; Letter dated November 16, 1999 from Ernst & Young LLP. *See also* Letter dated August 20, 1999 from Ernst & Young LLP to Harvey J. Goldschmid, General Counsel, and Lynn E. Turner, Chief Accountant, SEC, commenting on the recommendations of the Blue Ribbon Committee and recommending a variation of this alternative.

[56] Delaware General Corporation Law, for example, states that board members are ''fully protected in relying on good faith upon the records of the corporation and upon such information, opinions, reports or statements presented to the corporation by any of the corporation's officers or employees * * * or by any other person as to matters the member reasonably believes are within such other person's professional or expert competence * * *.'' Del. Code Ann. tit. 8, § 141(e).

[57] *See* Blue Ribbon Report, *supra* note 9, at 34.

[58] This approach is consistent with the current treatment for the report from the company's compensation committee. *See* Instruction 9 to Item 402(a)(3) of Regulation S–K, 17 CFR 229.402(a)(3).

[59] We note, however, that the revised listing standards of the NYSE, NASD, and AMEX require the audit committee to: (1) Adopt a formal written charter that is approved by the full board of directors and that specifies the scope of the committee's responsibilities, and how it carries out those responsibilities, including structure, processes, and membership requirements; and (2) review and reassess the adequacy of the audit committee's charter on an annual basis. *See supra* note 27.

[60] *See, e.g.,* Letter dated November 29, 1999 from William E. Eason, Jr., Senior Vice President and General Counsel, Scientific-Atlanta, Inc.; Letter dated November 29, 1999 from Paul V. Stahlin, Senior Vice President and Comptroller, Summit Bancorp.

[61] *See, e.g.,* TIAA–CREF Letter, *supra* note 42.

[62] Letter dated November 29, 1999 from David K. Owens, Edison Electric Institute.

body while lacking the substance.'' [63] Further, as the Blue Ribbon Committee noted, ''* * * common sense dictates that a director without any financial, family, or other material personal ties to management is more likely to be able to evaluate objectively the propriety of management's accounting, internal control and reporting practices.'' [64]

As noted in the Proposing Release, because of the importance of having an audit committee that is comprised of independent directors,[65] we believe that shareholders should know about the independence of the members. We believe that the new disclosures will accomplish that goal.

Under the revised listing standards of the NYSE, AMEX, and NASD, under exceptional and limited circumstances, companies may appoint to their audit committee one director who is not independent if the Board determines that membership on the committee by the individual is required by the best interests of the corporation and its shareholders, and the Board discloses, in the next annual proxy statement subsequent to such determination, the nature of the relationship and the reasons for that determination. We are adopting, as proposed, the requirement that companies whose securities are listed on the NYSE or AMEX or quoted on Nasdaq that have a non-independent audit committee member disclose the nature of the relationship that makes that individual not independent and the reasons for the Board's determination to appoint the director to the audit committee. Small business issuers are not required to comply with this requirement.

In addition, companies, including small business issuers, whose securities are listed on the NYSE or AMEX or quoted on Nasdaq, must disclose whether the audit committee members are independent, as defined in the applicable listing standards.[66] While companies are required to provide in their proxy statements certain disclosures that relate to the independence of directors,[67] we thought that it was important to make the disclosure about all of the audit committee members' independence explicit and clear for shareholders. For example, if we required disclosure about only those audit committee members who are not independent, there would have been an implication that all of the other members are independent. Because of the importance of having independent directors on the audit committee, shareholders should be informed explicitly, rather than implicitly, of each member's status.

While we recognize that the new requirements of the NYSE, AMEX, and NASD regarding independence of audit committees need not be complied with for 18 months, we think that companies will be able to provide the new disclosures in the first proxy season after year 2000 because, as a practical matter, to meet the 18-month deadline, most companies will elect new directors during the year 2000. For other companies, this will show their progress in moving toward compliance with the listing requirements.

We are also adopting, as proposed, the requirement that companies, including small business issuers, whose securities are not listed on the NYSE or AMEX or quoted on Nasdaq, disclose in their proxy statements whether, if they have an audit committee, the members are independent as defined in the NYSE's, AMEX's, or NASD's listing standards, and which definition was used. These companies would be able to choose which definition of ''independence'' to apply to the audit committee members in making the disclosure. Whichever definition is chosen must be applied consistently to all members of the audit committee.

E. Safe Harbors

We are adopting, as proposed, ''safe harbors'' for the new disclosures.[68] The ''safe harbors'' would track the treatment of compensation committee reports under Item 402 of Regulation S–K.[69] The safe harbors are in paragraph (c) in new Item 306 of Regulations S–K and S–B and paragraph (e)(v) of Schedule 14A. Under the ''safe harbors,'' the additional disclosure would not be considered ''soliciting material,'' ''filed'' with the Commission, subject to Regulation 14A or 14C (and, therefore, not subject to the antifraud provisions of Rules 14a–9 or 14c–6) [70] or to the liabilities of Section 18 of the Exchange Act, except to the extent that the company specifically requests that it be treated as soliciting material, or specifically incorporates it by reference into a document filed under the Securities Act or the Exchange Act.

Several commenters recommended that the Commission also provide a safe harbor from private litigation.[71] After careful consideration, we do not believe an additional safe harbor is necessary or appropriate. As discussed more fully above, in adopting the new rules and amendments, we do not intend to subject companies or their directors to increased exposure to liability under the federal securities laws, or to create new standards for directors to fulfill their duties under state corporation law. We do not believe that the disclosure requirements will result in increased exposure to liability or create new standards. We have modified the disclosure required in Item 306 in response to commenters' concerns. To the extent the disclosure requirements would result in more clearly defined procedures for, and disclosure of, the operation of the audit committee, liability claims alleging breach of fiduciary duties under state law actually may be reduced. Accordingly, we believe that the safe harbors adopted are appropriate and sufficient.

IV. Applicability to Foreign Private Issuers and Section 15(d) Reporting Companies

A. Foreign Private Issuers

We proposed to exclude from the new requirements foreign private issuers with a class of securities registered under Section 12 of the Exchange Act or that file reports under Section 15(d) of the Exchange Act.[72] Foreign private issuers currently are exempt from the proxy rules, are not required to file Quarterly Reports on Form 10–Q or 10–QSB,[73] and are subject to different corporate governance regimes in their

[63] Staff of the SEC, 95th Cong., 2d Sess., Report to Congress on the Accounting Profession and the Commission's Oversight Role, Subcommittee on Governmental Efficiency and the District of Columbia of the Senate Committee on Governmental Affairs, at 97 (Comm. Print July 1978). *See also* Blue Ribbon Report, *supra* note 9, at 22–23; Treadway Report, *supra* note 21, at 40–41; *In the Matter of McKesson & Robbins*, Accounting Series Release No. 19, Exchange Act Release No. 2707 (Dec. 5, 1940).

[64] Blue Ribbon Report, *supra* note 9, at 22.

[65] *See, e.g.*, TIAA–CREF Letter, *supra* note 42.

[66] The revised listing standards of the NASD and AMEX require that small business issuers have at least two members of their audit committee, a majority of whom must be independent. In responding to the new disclosure requirement, small business issuers, of course, can disclose that the listing standards of the NASD or AMEX do not require that all members of their audit committee be independent. *See supra* note 27.

[67] Item 7 of Schedule 14A requires companies to provide the disclosures required by Items 401 and 404(a) and (c) of Regulation S–K.

[68] *See* Blue Ribbon Report, *supra* note 9, at 35, recommending a safe harbor.

[69] *See* Instruction 9 to Item 402(a)(3) of Regulation S–K, 17 CFR 229.402(a)(3).

[70] The other antifraud provisions of the Exchange Act and Securities Act of 1933 (the ''Securities Act''), however, would continue to apply.

[71] *See, e.g.*, Letter dated November 29, 1999 from Katherine K. Combs, Deputy General Counsel and Corporate Secretary, PECO Energy Company; Letter dated November 30, 1999 from the American Society of Corporate Secretaries (the ''ASCS Letter'').

[72] 15 U.S.C. § 78o(d).

[73] A ''foreign private issuer'' must file reports on Form 6–K promptly after the information requried by the Form is made public in accordance with the laws of its home country or a foreign securities exchange. *See* 17 CFR 240.13a–16(b).

home countries. Accordingly, we do not believe it is appropriate to extend the new requirements to foreign private issuers at this time. The Commission, however, is continuing to consider how the periodic reporting requirements for domestic companies should apply to foreign private issuers.

B. Section 15(d) Reporting Companies

As noted in the Proposing Release, companies whose reporting obligations arise solely under Section 15(d) of the Exchange Act are not required to file proxy statements with the Commission. We solicited comment on whether we should require those companies to provide the new disclosures in their Form 10–Ks or some other filing. Because we believe that the disclosures are most relevant to voting decisions on the basis of disclosure in proxy statements, and because of the nature of the market for the securities of such companies, we are not adopting such a scheme. Accordingly, at this time we are not extending the proxy statement disclosure requirements to Section 15(d) companies.

V. Compliance Dates

Several commenters requested that we provide a transition period to allow companies time to consider the rules and to revise, if necessary, any of their procedures.[74] We agree, and have provided a transition period for compliance with the new requirements. Registrants must obtain reviews of interim financial information by their independent auditors starting with their Forms 10–Q or 10–QSB to be filed for fiscal quarters ending on or after March 15, 2000. Registrants must comply with the new proxy and information disclosure requirements (*e.g.*, the requirement to include a report of their audit committee in their proxy statements, provide disclosures regarding the independence of their audit committee members, and attach a copy of their audit committee's charter) for all proxy and information statements relating to votes of shareholders occurring after December 15, 2000. Companies who become subject to Item 302(a) as a result of today's amendments must comply with its requirements after December 15, 2000. Registrants voluntarily may comply with any of the new requirements prior to the compliance dates.

VI. Paperwork Reduction Act

Earlier this year, the staff submitted the proposed amendments to Regulations 14A and 14C to the Office of Management and Budget (''OMB'') for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. Regulations 14A and 14C contain ''collection of information'' requirements within the meaning of the Paperwork Reduction Act of 1995 (44 U.S.C. § 3501 *et seq.*). The titles for the collections of information are: (1) Proxy Statements—Regulation 14A (Commission Rules 14a–1 through 14a–15) and Schedule 14A; and (2) Information Statements—Regulation 14C (Commission Rules 14c–1 through 14c–7) and Schedule 14C. Also, in accordance with the Paperwork Reduction Act, we solicited comments on the accuracy of our burden estimates for Regulations 14A and 14C. We did not receive any comments that address specifically the estimated paperwork burdens associated with those collections of information. The comments we received primarily addressed the costs and benefits of the proposals in general terms, and liability concerns, rather than issues relating to the collection of information. Commenters' more generalized concerns about costs and benefits of the amendments are addressed more fully in the cost-benefit and other sections of this release.

We proposed and are adopting amendments that will require a company to include additional disclosures in Schedules 14A and 14C, including certain information about the company's audit committee. The audit committee will have to disclose whether it had certain discussions with management and the company's independent auditors. The substance of the discussions would not be required to be disclosed. Companies will also have to disclosure information regarding the independence of audit committee members. The amendments would also require companies that have adopted a written charter for their audit committee to include a copy of the charter as an appendix to Schedules 14A and 14C at least once every three years. The amendments do not require companies to prepare charters.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number. Schedule 14A (OMB Control No. 3235–0059)[75] and Schedule 14C (OMB Control No. 3235–0057)[76] were adopted pursuant to Sections 14(a) and 14(c) of the Exchange Act. Schedule 14A prescribes information that a company must include in its proxy statement to ensure that shareholders are provided material information relating to voting decisions. Schedule 14C prescribes information that a company must include in its information statement to shareholders where votes are solicited by means other than proxies.

We solicited comments on whether we should require all companies to comply with Item 302(a) of Regulation S–K. As discussed in previous sections of the release, Item 302(a) of Regulation S–K currently requires larger, more widely-held companies to supplement their annual financial information with disclosures of selected quarterly financial data. We are amending Item 302(a) to extend the requirements to all companies (but not small business issuers filing on small business forms and foreign private issuers) that have securities registered under Section 12(b) or 12(g) of the Exchange Act. The Item 302(a) information will continue to appear as a table in the Form 10–K.

Form 10–K under the Exchange Act (OMB Control Number 3235–0063)[77] is used by registrants to file annual reports. The title for this collection of information is Form 10–K. Form 10–K provides a comprehensive overview of the registrant's business and financial condition. The Commission estimates that Form 10–K currently results in a total annual compliance burden of approximately 17,886,463 hours. The burden was calculated by multiplying the estimated number of entities filing Form 10–K (approximately 10,381) by the estimated average number of hours each entity spends completing the Form (approximately 1723 hours). The Commission based the number of entities that complete and file Form 10–K on the actual number of filers during the 1998 fiscal year. The staff estimated the average number of hours an entity spends completing Form 10–K by contacting a number of law firms and other persons regularly involved in completing the forms.

We estimate that the incremental burden of extending Item 302(a) to all companies with securities registered under Sections 12(b) or 12(g) of the Exchange Act (except small business issuers filing on small business forms) will increase the total by approximately 2000 hours. This burden was calculated by multiplying the estimated number of entities that do not currently provide Item 302(a) information by the number of additional hours it would take to provide the additional information. The staff estimates that approximately 8000 Form 10–K filers do not currently provide Item 302(a) information, and

[74] *See, e.g.*, ASCS Letter, *supra* note 71.

[75] 17 CFR 240.14a–101.

[76] 17 CFR 240.14c–101.

[77] 17 CFR 249.310.

that it would take a total of approximately .25 hours to include the new disclosure in a Form 10–K. The Commission based the number of Form 10–K filers not currently providing Item 302(a) information on the approximate number of companies in the Compustat database that currently are required to file Item 302(a) information based on the criteria set forth in Item 302(a) of Regulation S–K.

We believe that the amendments will promote investor confidence in the securities markets by informing investors about the important role that audit committees play in the financial reporting process and will enhance the reliability and credibility of financial statements of public companies.

Compliance with the disclosure requirements is mandatory. There will be no mandatory retention period for the information disclosed, and responses to the disclosure requirements will not be kept confidential.

Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comments to: (i) Evaluate whether the revised rule is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility; (ii) evaluate the accuracy of the Commission's estimate of the burden of the proposed collection of information; (iii) determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and (iv) evaluate whether there are ways to minimize the burden of the collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

Persons submitting comments on the collection of information requirements for Form 10–K should direct the comments to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should send a copy to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549–0609, with reference to File No. S7–22–99. Requests for materials submitted to OMB by the Commission with regard to these collections of information should be in writing, refer to File No. S7–22–99, and be submitted to the Securities and Exchange Commission, Records Management, Office of Filings and Information Services. OMB is required to make a decision concerning the collection of information between 30 and 60 days after publication of this release. Consequently, a comment to OMB is assured of having its full effect if OMB receives it within 30 days of publication.

VII. Cost-Benefit Analysis

The amendments are expected to improve disclosure related to the functioning of the corporate audit committees and to enhance the reliability and credibility of financial statements of public companies. We believe that the amendments will promote investor confidence in the securities markets by informing investors about the important role that audit committees play in the financial reporting process. As the Blue Ribbon Committee summarized:

> Improving oversight of the financial reporting process necessarily involves the imposition of certain burdens and costs on public companies. Despite these costs, the Committee believes that a more transparent and reliable financial reporting process ultimately results in a more efficient allocation of and lower cost of capital. To the extent that instances of outright fraud, as well as other practices that result in lower quality financial reporting, are reduced with improved oversight, the benefits clearly justify these expenditures of resources.[78]

As noted above, the amendments are part of a larger, coordinated series of actions by the NYSE, NASD, AMEX, and the accounting profession that were recommended by the Blue Ribbon Committee to improve the financial reporting process. The Commission's rule amendments and new rules complement and strengthen the efforts of the NYSE, NASD, AMEX and the accounting profession. This cost-benefit analysis concentrates only on the effect of the Commission's rules. The benefits of the new requirements cannot be readily quantified.[79] However, these measures should mitigate inappropriate earnings management, enhance the reliability of financial information, improve disclosure to investors, and could improve securities pricing efficiency by encouraging the distribution of higher quality earnings numbers on a more timely basis.

Reviews of Quarterly Financial Statements

We are requiring interim reviews of quarterly financial statements filed on Form 10–Q or 10–QSB.[80] Under the amendments, a company's quarterly financial statements must be reviewed by independent auditors using ''professional standards and procedures for conducting such reviews, as established by generally accepted auditing standards, as may be modified or supplemented by the Commission.'' Currently, that means that the review would follow the procedures established by SAS 71. The amendments apply only to the financial information contained in the company's Quarterly Reports on Form 10–Q or 10–QSB. Accordingly, the amendments do not require any review of quarterly financial information released to the public before the filing of the Form 10–Q or 10–QSB, such as the so-called quarterly ''earnings release.''

We believe that companies are under increasing pressure to meet financial analysts' expectations, and that pressure can be even more acute in the context of reports on quarterly earnings. We believe that the participation of auditors in the financial reporting process at interim dates will help to counterbalance that pressure and impose increased discipline on the process of preparing interim financial information.[81] Auditor involvement in the financial reporting process earlier in the year should facilitate timely identification and resolution of significant and sensitive issues and result in fewer year-end adjustments, which should reduce the cost of annual audits.[82] The increased focus and discipline imposed on the preparation of interim financial statements should enhance the efficiency of the capital markets by improving the reliability of quarterly financial statements, although these benefits are difficult to quantify.

We have prepared our best estimate of the incremental costs of preparing a SAS 71 review for those companies not currently having them performed. Our estimate of those incremental costs is based on data provided to the staff by the SEC Practice Section of the AICPA (''SECPS''), discussions with experienced practitioners, the experiences of current SEC staff members, and data provided by commenters.

Firms providing information to the SECPS indicated that the procedures they currently use are similar, if not the same, as those described in SAS 71. Most indicated that review reports are seldom issued. The firms also indicated

[78] Blue Ribbon Report, *supra* note 9, at 19.

[79] OMB, *Report to Congress on the Costs and Benefits of Federal Regulation* 21 (1998) (OMB has recognized that while it may be difficult to quantify the benefits of disclosure requirements, there is a strong consensus among economists that, in general, disclosure-based regulatory schemes can improve the functioning of markets and produce significant benefits for consumers).

[80] *See* Section III.A above.

[81] COSO Report, *supra* note 26, at 34 (''Close scrutiny of quarterly financial information and a move toward continuous auditing strategies may increase opportunities for earlier detection of financial statement improprieties'').

[82] *See, e.g.*, AIMR Letter, *supra* note 33.

that they are not aware of (and do not expect) clients switching auditing firms because of their new policies.

The firms providing information to the SECPS identified several unquantifiable benefits that they believe would result from the reviews, including better interim reporting, earlier identification and resolution of accounting issues, improvement in the quality of accounting estimates, and improved communications between clients and auditors. These benefits could also improve pricing efficiency of the issuer's securities. Several comment letters from accounting firms supported this view.[83] Medium and smaller sized accounting firms, however, indicated to the SECPS that SAS 71 reviews of small companies' interim financial statements may cause delays in filing Forms 10–Q or 10–QSB, be relatively more costly for small companies, be hampered by inadequate financial reporting processes, and would result in small companies shifting work from the company to the CPA firm. One small business commenter expressed concern that increased pressure to meet the filing deadlines would require hiring another employee.[84] Based on staff experience and discussions with practitioners, we believe many of the required review procedures can be performed simultaneously with the preparation of the quarterly financial statements, and accordingly, should not delay these filings. In addition, we believe that the same management personnel who work with the auditors at year end should be able to assist with the quarterly reviews.

The firms responding to the SECPS generally indicated that the costs of reviews of quarterly financial statements vary depending on several factors, including: (i) The sophistication of the client's accounting and reporting system; (ii) The quality of the client's accounting personnel; (iii) The identification of ''fraud risk factors;'' (iv) The client's industry; (v) The number and location of the client's subsidiaries; (vi) The seasonality of the client's business; (vii) The existence of contentious accounting issues; and (viii) Whether there will be a staffing ''crunch'' at the firm to handle the reviews each quarter.

The five largest U.S. accounting firms, the so-called ''Big 5,'' and some other firms, currently have in place policies that require their clients to have interim reviews as a condition to acceptance of an audit. Based on the Compustat database and information from the SECPS and from commenters, we estimate that approximately 8,934 companies for calendar year 1998 retained auditors that require SAS 71 reviews. Based on a total of approximately 12,972 Forms 10–K and 10–KSB filed in 1998, we therefore estimate that approximately 4,038 companies are not currently subject to SAS 71 reviews.

Based on the data provided to staff by the SECPS, our experience, and information from commenters, we estimate the incremental cost to conduct a SAS 71 review will be nominal for those companies currently audited by the Big 5 firms and for the remaining companies would range from approximately $1,000 to about $4,000[85] per quarter. Multiplying $7,500 (the midpoint of the average cost per firm of $3,000 to $12,000 per year) by 4038 produces an estimated $30 million a year cost for SAS 71 reviews.[86] Obviously, if more companies are currently subject to SAS 71 reviews, or if the cost of the reviews is offset by a reduction in annual fees, the cost estimate would be smaller.

Disclosure Related to the Functioning of the Audit Committee

The principal benefits of the proposals are improved disclosure relating to the functioning of corporate audit committees and enhanced reliability and credibility of financial statements. The benefits of improved disclosure regarding the audit committee's communications with management and the independent auditors are not readily quantifiable. We believe, however, that they would include increased market efficiency due to improved information and investor confidence in the reliability of companies' financial disclosures. As discussed above, most of the commenters supported the goals of improving disclosure about audit committees, although some suggested alternative disclosure requirements. Commenters' principal concern was that audit committees may be exposed to additional liability, with the result that they would find it more difficult to recruit qualified audit committee members; others disagreed with that view. As discussed above, we modified the Item 306 audit committee report requirement to respond to commenters' concerns about liability.

We believe the costs associated with these amendments would derive principally from the disclosure obligations—we are not placing any substantive requirements on audit committees or their members. At the proposing stage, we estimated that the additional disclosure contemplated by the amendments would, on average, require less than three-fourths of a page in a company's proxy statement, based on the staff's experience with proxy statements, and analogous cost estimates. A financial printing company informed the staff that this disclosure would not likely increase the printing cost because up to three-fourths of a page can normally be incorporated without increasing the page length by reformatting the document. The printer reported that adding one more page could increase costs by about $1,500 for an average sized company.

Only a few commenters mentioned printing costs, with one stating that the costs of printing the charter in the proxy statement ''could be significant,'' but did not quantify the amount.[87] We continue to believe that the printing costs of the disclosures and charter[88] would not be significant. The charter, for example, needs to be printed only once every three years, so the cost has been averaged over three years. We estimate the total average disclosure per year—the average annual burden of printing the charter and the other disclosures—would be one printed proxy statement page. Consequently, the annual aggregate cost would be approximately $15 million.[89]

This amount, however, does not include possible ''start up'' costs for some companies. First, some companies may have to set up procedures to monitor the activities of their audit committee in order to collect and record the information required by the amendments. In our view, such monitoring costs are most likely to result from disclosing the fact of the audit committee's discussions with management and the independent auditors and receiving from the independent auditors certain required disclosures and a letter from the

[83] *See, e.g.,* KPMG Letter, *supra* note 25 (''In our experience that policy [of conducting SAS 71 reviews] has resulted in the earlier identification of accounting and reporting issues and has therefore enhanced the quality of interim financial reporting'').

[84] Letter dated November 22, 1999 from Michael Dee.

[85] One non-Big 5 accounting firm indicated in its comment letter that the upper end of the range (*i.e.,* about $4,000 per quarter) comported with its experience for small to medium size companies. Letter dated October 14, 1999 from Edward W. O'Connell, Wiss & Company, LLP.

[86] At the proposing stage, we used 2,150 companies to reach an estimate of $16 million.

[87] *See* NYS Bar Letter, *supra* note 25.

[88] Preparation of the charter is required by the NYSE, NASD, and AMEX and not the Commission's rules.

[89] The $15 million figure derives from one page at $1,500 per page for approximately 10,145 companies.

independent auditors. We believe such monitoring costs will be insignificant.

Second, some companies may seek the help of outside experts, particularly outside legal counsel, in formulating responses to the new requirements.[90] In some circumstances, for instance, the audit committee may seek the advice of legal counsel before making the required disclosure about the audited financial statements. Commenters provided no cost data. We understand that many audit committees already use outside experts, but do not know what, if any, incremental cost there will be. As we modified our proposals to reflect better the oversight role of audit committees and address liability concerns, we anticipate that any costs attributable to the increased use of outside experts to respond to the new disclosure requirements will be negligible.

For purposes of the Paperwork Reduction Act, we estimated that our required disclosures would, on average, impose one additional burden hour, exclusive of printing costs, on each filer of Schedule 14A or 14C, or an aggregate annual total of 10,145 additional burden hours. This estimate reflects the time companies would spend preparing the additional disclosures in the proxy statement.[91] The total annual costs accordingly would be approximately $1 million.

These amendments are not intended to increase companies' or directors' exposure to liability under federal or state law. A number of commenters indicated that, in their assessment, the proposals would have the effect of increasing the companies' and/or directors' exposure to liability, with attendant costs, but provided no economic data. For the reasons discussed in previous sections of this release, we believe that the amendments will likely result in better and more reliable financial reporting, but should not increase liability exposure. In particular, we modified requirements to address this liability concern. In addition, the amendments include liability ''safe harbors'' similar to those that apply to compensation committee reports under current rules.[92]

Item 302(a) of Regulation S–K

The Commission is requiring more companies to provide the supplemental financial information described in Item 302 of Regulation S–K. That information consists of selected quarterly financial data, such as net sales and gross profit, for the prior two years. We recognize that requiring all public companies (except Form S–B filers, Section 15(d) reporting companies, and foreign private issuers) to provide supplemental financial information under Item 302(a) of Regulation S–K may have some incremental cost. Currently only certain large, widely-held companies that meet certain tests (involving, among other things, the number of security holders, stock price, and market capitalization) must file supplemental financial information. Taking into account that auditors will be performing SAS 71 reviews for these companies, the incremental cost of preparing and presenting the supplementary financial information is small.

Based on the staff's experience, we do not believe that it will take company employees much time to pull the data from their prior quarterly reports to prepare the supplementary financial information for the Form 10–K. While the information will take up part of an additional page in the Form 10–K, there are no printing costs attributable to disclosure of this information since it is not typically contained in the annual report that is printed and distributed to investors.

We believe the supplementary financial information is a useful resource for investors and justifies the cost of its collection and filing. By tying the regulatory threshold to an existing, widely used test (*e.g.,* the definition of small business issuer in Regulation S–B), the Commission is simplifying the regulatory scheme. Such simplification is an additional benefit of the amendments.

VIII. Consideration of Impact on the Economy, Burden on Competition, and Promotion of Efficiency, Competition, and Capital Formation

Section 3(f) of the Exchange Act requires the Commission, when engaging in rulemaking that requires it to consider or determine whether an action is necessary or appropriate in the public interest, also to consider whether the action will promote efficiency, competition, and capital formation. We believe that the proposals will promote investor confidence in the securities markets by improving the transparency of the role of corporate audit committees and enhancing the reliability and credibility of financial statements of public companies. More reliable financial statements should help to lower the costs of capital. Accordingly, the proposals should promote capital formation and market efficiency.

Section 23(a) of the Exchange Act requires the Commission, when adopting rules under the Exchange Act, to consider the impact on competition of any rule it adopts. We do not believe that the proposals would have any anti-competitive effects since the proposals should improve the transparency, reliability, and credibility of companies' financial statements. We requested comment on any anti-competitive effects of the proposals. For the reasons discussed above, we have decided to exclude foreign private issuers from these disclosure requirements. Any competitive effect that may occur by requiring domestic public companies to comply with these additional disclosure requirements, compared to foreign private issuers, is necessary and appropriate for the protection of investors.

IX. Final Regulatory Flexibility Analysis

This Final Regulatory Flexibility Analysis has been prepared in accordance with the Regulatory Flexibility Act (''RFA''). It relates to amendments to Rule 10–01 of Regulation S–X, Item 310 of Regulation S–B, Item 302(a) of Regulation S–K, Item 7 of Schedule 14A under the Exchange Act, and new Item 306 of Regulations S–B and S–K.

A. Need for the Rules and Rule Amendments

The new rules and amendments to current rules are designed to improve disclosure relating to the functioning of corporate audit committees and to enhance the reliability and credibility of financial statements of public companies. The required disclosure will help inform shareholders of the audit committee's role in overseeing the preparation of the financial statements and underscore the importance of the audit committee's participation in the financial reporting process.

The required reviews of interim financial information should facilitate early identification and resolution of material accounting and reporting issues because the auditors will be involved earlier in the year. More reliable interim financial information will be available to investors, and early involvement of the auditors should reduce the number of restatements or other year-end adjustments. We believe that the disclosures will reinforce the audit

[90] *See, e.g.,* Letter dated November 19, 1999 from Patricia Gallup, Chairman of the Board, PC Connection, Inc.

[91] The estimate does not include the amount of time the audit committee would spend conducting the discussions with the independent accountants and management to which new Item 306 of Regulations S–K and S–B and the amendments to Item 7 of Schedule 14A refer. The amendments would not require that the audit committee hold the discussions, but merely that it disclose whether the discussions have taken place.

[92] *See* Section III.E above.

committee's awareness of its responsibilities, and make visible for shareholders the audit committee's role in promoting reliable and transparent financial reporting.

B. Significant Issues Raised by Public Comment

Many commenters were concerned that the proposed rules would expose audit committee members to increased scrutiny and liability. As a result, those commenters suggested that we amend certain disclosure requirements and provide an additional safe harbor from private litigation. We modified the required audit committee report to address the liability concerns, and consequently, as discussed in previous sections of this release, we do not believe additional safe harbors are necessary or appropriate. We are adopting, as proposed, the same report requirements and safe harbors for companies of all sizes.

The Commission requested comment on whether the scope of the proposed rules should be narrowed to exclude companies under a certain size. Some commenters questioned the need for interim reviews for small entities,[93] particularly in light of the additional costs. However, we continue to believe that improving the interim reporting process is important for small companies. Investors rely on and react quickly to quarterly results of companies, large and small. Moreover, the COSO Report found that the incidence of financial fraud was greater at small companies.[94] The COSO Report specifically noted that the ''concentration of fraud among companies with under $50 million in revenues and with generally weak audit committees highlights the importance of rigorous audit committee practices, even for smaller organizations.'' [95] In light of the COSO Report, we believe it would be inconsistent with the purposes of the rule to exempt small business issuers from the proposed requirement for interim reviews.

We also solicited comment on whether we should require all companies to comply with Item 302(a) of Regulation S–K. Commenters generally agreed that we should extend the requirements to other companies, but questioned the need to include small companies. We are adopting the Item 302(a) requirement for all Section 12(b) and 12(g) registered companies (except small business issuers reporting on small business forms) to maintain the more simplified reporting format of the regulatory scheme for small business issuers.

C. Small Entities Subject to the Rule

For purposes of the RFA, Exchange Act Rule 0–10 defines ''small business'' as a company whose total assets on the last day of its most recent fiscal year were $5 million or less.[96] The rules will affect small businesses that are required to file proxy materials on Schedule 14A or 14C and Quarterly Reports on Form 10–Q or 10–QSB under the Exchange Act. We estimate that there are approximately 830 reporting companies (that are not investment companies) with assets of $5 million or less. The Commission bases its estimate on information from the Insight database from Compustat, a division of Standard and Poors.

D. Projected Reporting, Recordkeeping, and Other Compliance Requirements

1. Reviews of Quarterly Financial Statements

The rules will require companies to engage their independent auditors to conduct interim reviews of their quarterly financial statements prior to the company filing its Forms 10–Q or 10–QSB. Based on information provided to the Commission by the SECPS,[97] it appears that most companies already engage their independent auditors to undertake some level of review of their quarterly financial statements.

Medium and smaller sized accounting firms indicated to the SECPS that SAS 71 reviews of small companies' interim financial statements may cause delays in filing Forms 10–Q or 10–QSB, be relatively more costly for all companies, be hampered by inadequate financial reporting processes, and would result in small companies shifting financial responsibilities from the company to the CPA firm.

However, based on the SECPS survey, we believe that the costs of compliance would be partially offset by a reduction in year-end audit fees and would lead to earlier identification of accounting and auditing issues and an improvement in the quality of the process used for preparing interim financial reports.

2. Disclosure Related to the Functioning of the Audit Committee

Issuers, both large and small, will be required to provide certain additional disclosure in their proxy statements regarding the company's audit committee, including attaching every three years a copy of the audit committee's charter, if they have one. Companies will be required to include reports of their audit committees in which the audit committee provides disclosure about whether certain discussions between the audit committee and management and the auditors took place. No disclosure of the substance of the discussions is required. The increased disclosure will require all entities, large and small, to spend additional time and incur additional costs in preparing disclosures. In particular, smaller companies may incur additional costs to set up procedures in order to respond to the new disclosure requirements. Smaller companies may also incur additional costs in seeking the help of outside experts, particularly outside legal counsel, in formulating responses to the new requirements.

3. Disclosure Related to Independence

We are requiring that companies whose securities are listed on the NYSE, AMEX, or traded on Nasdaq make certain disclosures about any member of the audit committee who is not independent (small business issuers are not subject to that requirement) and whether the audit committee members are independent. Companies, including small business issuers, whose securities are not listed on the NYSE or AMEX or quoted on Nasdaq are required to disclose whether their members are independent, but may choose which definition of independence to use and must disclose which definition was used.

E. Agency Action To Minimize Effect on Small Entities

As required by Section 603 of the RFA, the Commission has considered the following alternatives to minimize the economic impact of the rules on small entities: (a) The establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; (b) the clarification, consolidation, or simplification of compliance and reporting requirements under the rules for small entities; (c) the use of performance rather than design standards; and (d) an exemption from coverage of the rules, or any part thereof, for small entities.

[93] *See* ABA Letter, *supra* note 34.

[94] *See generally* COSO Report, *supra* note 26. In fact, the COSO Report specifically found that a ''regulatory focus on companies with market capitalization in excess of $200 million may fail to target companies with greater risk for financial statement fraud activities.'' *Id.* at 4.

[95] COSO Report, *supra* note 26, at 5.

[96] A ''small business issuer'' under Regulation S–B, however, is a company with less than $25 million in revenues and market capitalization.

[97] *See* Section VII above.

We continue to believe investors in smaller companies would want and benefit from the disclosures about the audit committee and the advantages of interim reviews just as much as investors in larger companies. We have made some adjustments to the rules to decrease their impact on small businesses. For example, we did not extend Item 302(a) to small business issuers filing on small business forms.

In addition, small businesses not subject to the NASD's, AMEX's or NYSE's listing standards can choose which definition of independence to use, as long as it is used consistently. Further, small business issuers are not required to state the reasons for including a non-independent audit committee member, since under the listing standards, they are not required to have all independent members on their audit committees.

Finally, to provide companies with the opportunity to evaluate their compliance with the revised listing standards of the NASD, AMEX, and NYSE and to prepare for the new disclosure requirements, we are providing transition periods for compliance with the new requirements, which should benefit all companies, large and small.

X. Statutory Bases and Text of Amendments

We are adopting amendments to Rules 10–01 of Regulation S–X and 14a–101 (Schedule 14A), Item 310 of Regulation S–B, and Item 302(a) of Regulation S–K, and adopting new Item 306 of Regulations S–K and S–B, under the authority set forth in Sections 2, 13, 14, and 23 of the Exchange Act.

List of Subjects

17 CFR Part 210

Accountant, Accounting, Reporting and recordkeeping requirements, Securities.

17 CFR Part 228

Reporting and recordkeeping requirements, Securities, Small businesses.

17 CFR Parts 229 and 240

Reporting and recordkeeping requirements, Securities.

Text of Amendments

In accordance with the foregoing, Title 17, Chapter II of the Code of Federal Regulations is amended as follows:

PART 210—FORM AND CONTENT OF AND REQUIREMENTS FOR FINANCIAL STATEMENTS, SECURITIES ACT OF 1933, SECURITIES EXCHANGE ACT OF 1934, PUBLIC UTILITY HOLDING COMPANY ACT OF 1935, INVESTMENT COMPANY ACT OF 1940, AND ENERGY POLICY AND CONSERVATION ACT OF 1975

1. The authority citation for part 210 continues to read as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 77z–2, 77aa(25), 77aa(26), 78j–1, 78*l*, 78m, 78n, 78o(d), 78u–5, 78w(a), 78*ll*(d), 79e(b), 79j(a), 79n, 79t(a), 80a–8, 80a–20, 80a–29, 80a–30, 80a–37(a), unless otherwise noted.

2. By amending § 210.10–01 by revising paragraph (d) to read as follows:

§ 210.10–01 Interim financial statements.

* * * * *

(d) *Interim review by independent public accountant.* Prior to filing, interim financial statements included in quarterly reports on Form 10–Q (17 CFR 249.308(a)) must be reviewed by an independent public accountant using professional standards and procedures for conducting such reviews, as established by generally accepted auditing standards, as may be modified or supplemented by the Commission. If, in any filing, the company states that interim financial statements have been reviewed by an independent public accountant, a report of the accountant on the review must be filed with the interim financial statements.

* * * * *

PART 228—INTEGRATED DISCLOSURE SYSTEM FOR SMALL BUSINESS ISSUERS

3. The authority citation for part 228 continues to read as follows:

Authority: 15 U.S.C. 77e, 77f, 77g, 77h, 77j, 77k, 77s, 77z–2, 77aa(25), 77aa(26), 77ddd, 77eee, 77ggg, 77hhh, 77jjj, 77nnn, 77sss, 78*l*, 78m, 78n, 78o, 78u–5, 78w, 78*ll*, 80a–8, 80a–29, 80a–30, 80a–37, 80b–11, unless otherwise noted.

4. Section 228.305 is added and reserved and § 228.306 is added to read as follows:

§ 228.305 [Reserved]

§ 228.306 (Item 306) Audit committee report.

(a) The audit committee must state whether:

(1) The audit committee has reviewed and discussed the audited financial statements with management;

(2) The audit committee has discussed with the independent auditors the matters required to be discussed by SAS 61, as may be modified or supplemented;

(3) The audit committee has received the written disclosures and the letter from the independent accountants required by Independence Standards Board Standard No. 1 (Independence Standards Board Standard No. 1, *Independence Discussions with Audit Committees*), as may be modified or supplemented, and has discussed with the independent accountant the independent accountant's independence; and

(4) Based on the review and discussions referred to in paragraphs (a)(1) through (a)(3) of this Item, the audit committee recommended to the Board of Directors that the audited financial statements be included in the company's Annual Report on Form 10–KSB (17 CFR 249.310b) for the last fiscal year for filing with the Commission.

(b) The name of each member of the company's audit committee (or, in the absence of an audit committee, the board committee performing equivalent functions or the entire board of directors) must appear below the disclosure required by this Item.

(c) The information required by paragraphs (a) and (b) of this Item shall not be deemed to be ''soliciting material,'' or to be ''filed'' with the Commission or subject to Regulation 14A or 14C (17 CFR 240.14a–1 *et seq.* or 240.14c–1 *et seq.*), other than as provided in this Item, or to the liabilities of section 18 of the Exchange Act (15 U.S.C. 78r), except to the extent that the company specifically requests that the information be treated as soliciting material or specifically incorporates it by reference into a document filed under the Securities Act or the Exchange Act.

(d) The information required by paragraphs (a) and (b) of this Item need not be provided in any filings other than a registrant proxy or information statement relating to an annual meeting of security holders at which directors are to be elected (or special meeting or written consents in lieu of such meeting). Such information will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the registrant specifically incorporates it by reference.

5. By amending § 228.310 by revising the introductory text of paragraph (b) to read as follows:

§ 228.310 (Item 310) Financial Statements.

* * * * *

(b) *Interim Financial Statements.* Interim financial statements may be unaudited; however, prior to filing,

interim financial statements included in quarterly reports on Form 10–QSB (17 CFR 249.308b) must be reviewed by an independent public accountant using professional standards and procedures for conducting such reviews, as established by generally accepted auditing standards, as may be modified or supplemented by the Commission. If, in any filing, the issuer states that interim financial statements have been reviewed by an independent public accountant, a report of the accountant on the review must be filed with the interim financial statements. Interim financial statements shall include a balance sheet as of the end of the issuer's most recent fiscal quarter and income statements and statements of cash flows for the interim period up to the date of such balance sheet and the comparable period of the preceding fiscal year.

* * * * *

PART 229—STANDARD INSTRUCTIONS FOR FILING FORMS UNDER SECURITIES ACT OF 1933, SECURITIES EXCHANGE ACT OF 1934 AND ENERGY POLICY AND CONSERVATION ACT OF 1975—REGULATION S–K

6. The authority citation for part 229 continues to read in part as follows:

Authority: 15 U.S.C. 77e, 77f, 77g, 77h, 77j, 77k, 77s, 77z–2, 77aa(25), 77aa(26), 77ddd, 77eee, 77ggg, 77hhh, 77iii, 77jjj, 77nnn, 77sss, 78c, 78i, 78j, 78*l*, 78m, 78n, 78o, 78u–5, 78w, 78*ll*(d), 79e, 79n, 79t, 80a–8, 80a–29, 80a–30, 80a–37, 80b–11, unless otherwise noted.

* * * * *

7. By amending § 229.302 by revising paragraph (a)(5) to read as follows:

§ 229.302 (Item 302) Supplementary financial information.

(a) *Selected quarterly financial data.*

* * *

(5) This paragraph (a) applies to any registrant, except a foreign private issuer, that has securities registered pursuant to sections 12(b) (15 U.S.C. § 78*l*(b)) (other than mutual life insurance companies) or 12(g) of the Exchange Act (15 U.S.C. § 78*l*(g)).

* * * * *

8. By adding § 229.306 to read as follows:

§ 229.306 (Item 306) Audit committee report.

(a) The audit committee must state whether:

(1) The audit committee has reviewed and discussed the audited financial statements with management;

(2) The audit committee has discussed with the independent auditors the matters required to be discussed by SAS 61 (Codification of Statements on Auditing Standards, AU § 380), as may be modified or supplemented;

(3) The audit committee has received the written disclosures and the letter from the independent accountants required by Independence Standards Board Standard No. 1 (Independence Standards Board Standard No. 1, *Independence Discussions with Audit Committees*), as may be modified or supplemented, and has discussed with the independent accountant the independent accountant's independence; and

(4) Based on the review and discussions referred to in paragraphs (a)(1) through (a)(3) of this Item, the audit committee recommended to the Board of Directors that the audited financial statements be included in the company's Annual Report on Form 10–K (17 CFR 249.310) (or, for closed-end investment companies registered under the Investment Company Act of 1940 (15 U.S.C. 80a–1 *et seq.*), the annual report to shareholders required by Section 30(e) of the Investment Company Act of 1940 (15 U.S.C. 80a–29(e)) and Rule 30d–1 (17 CFR 270.30d–1) thereunder) for the last fiscal year for filing with the Commission.

(b) The name of each member of the company's audit committee (or, in the absence of an audit committee, the board committee performing equivalent functions or the entire board of directors) must appear below the disclosure required by this Item.

(c) The information required by paragraphs (a) and (b) of this Item shall not be deemed to be ''soliciting material,'' or to be ''filed'' with the Commission or subject to Regulation 14A or 14C (17 CFR 240.14a–1 *et seq.* or 240.14c–1 *et seq.*), other than as provided in this Item, or to the liabilities of section 18 of the Exchange Act (15 U.S.C. 78r), except to the extent that the company specifically requests that the information be treated as soliciting material or specifically incorporates it by reference into a document filed under the Securities Act or the Exchange Act.

(d) The information required by paragraphs (a) and (b) of this Item need not be provided in any filings other than a company proxy or information statement relating to an annual meeting of security holders at which directors are to be elected (or special meeting or written consents in lieu of such meeting). Such information will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the company specifically incorporates it by reference.

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

9. The authority citation for part 240 continues to read, in part, as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z–2, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78f, 78i, 78j, 78j–1, 78k, 78k–1, 78l, 78m, 78n, 78o, 78p, 78q, 78s, 78u–5, 78w, 78x, 78*ll*(d), 78mm, 79q, 79t, 80a–20, 80a–23, 80a–29, 80a–37, 80b–3, 80b–4 and 80b–11, unless otherwise noted.

* * * * *

10. By amending § 240.14a–101 by adding paragraph (e)(3) to Item 7 to read as follows:

§ 240.14a–101 Schedule 14A. Information required in proxy statement.

* * * * *

Item 7. *Directors and executive officers.*

* * *

(e) * * *

(3) If the registrant has an audit committee:

(i) Provide the information required by Item 306 of Regulation S–K (17 CFR 229.306).

(ii) State whether the registrant's Board of Directors has adopted a written charter for the audit committee.

(iii) Include a copy of the written charter, if any, as an appendix to the registrant's proxy statement, unless a copy has been included as an appendix to the registrant's proxy statement within the registrant's past three fiscal years.

(iv)(A) For registrants whose securities are listed on the New York Stock Exchange (''NYSE'') or American Stock Exchange (''AMEX'') or quoted on Nasdaq:

(*1*) Disclose whether the members of the audit committee are independent (as independence is defined in Sections 303.01(B)(2)(a) and (3) of the NYSE's listing standards, Section 121(A) of the AMEX's listing standards, or Rule 4200(a)(15) of the National Association of Securities Dealers' (''NASD'') listing standards, as applicable and as may be modified or supplemented); and

(*2*) If the registrant's Board of Directors determines in accordance with the requirements of Section 303.02(D) of the NYSE's listing standards, Section 121(B)(b)(ii) of the AMEX's listing standards, or Section 4310(c)(26)(B)(ii) or 4460(d)(2)(B) of the NASD's listing standards, as applicable and as may be modified or supplemented, to appoint one director to the audit committee who is not independent, disclose the nature of the relationship that makes that individual not independent and the reasons for the Board's determination. Small business issuers (17 CFR 228.10(a)(1)) need not provide the information required by this paragraph (e)(3)(iv)(A)(2).

(B) For registrants, including small business issuers, whose securities are not listed on the NYSE or AMEX or quoted on Nasdaq, disclose whether, if the registrant

has an audit committee, the members are independent. In determining whether a member is independent, registrants must use the definition of independence in Sections 303.01(B)(2)(a) and (3) of the NYSE's listing standards, Section 121(A) of the AMEX's listing standards, or Rule 4200(a)(15) of the NASD's listing standards, as such sections may be modified or supplemented, and state which of these definitions was used. Whichever definition is chosen must be applied consistently to all members of the audit committee.

(v) The information required by paragraph (e)(3) of this Item shall not be deemed to be ''soliciting material,'' or to be ''filed'' with the Commission or subject to Regulation 14A or 14C (17 CFR 240.14a–1 *et seq.* or 240.14c–1 *et seq.*), other than as provided in this Item, or to the liabilities of section 18 of the Exchange Act (15 U.S.C. 78r), except to the extent that the registrant specifically requests that the information be treated as soliciting material or specifically incorporates it by reference into a document filed under the Securities Act or the Exchange Act. Such information will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the registrant specifically incorporates it by reference.

(vi) The disclosure required by this paragraph (e)(3) need only be provided one time during any fiscal year.

(vii) Investment companies registered under the Investment Company Act of 1940 (15 U.S.C. 80a–1 *et seq.*), other than closed-end investment companies, need not provide the information required by this paragraph (e)(3).

* * * * *

Dated: December 22, 1999.

By the Commission.

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 99–33849 Filed 12–29–99; 8:45 am]

BILLING CODE 8010–01–U

DEPARTMENT OF ENERGY

Federal Energy Regulatory Commission

18 CFR Parts 375 and 376

[Docket No. RM00–4–000; Order No. 613]

Delegations of Authority

Issued December 21, 1999.

AGENCY: Federal Energy Regulatory Commission, DOE.

ACTION: Final rule.

SUMMARY: The Federal Energy Regulatory Commission (Commission) is amending regulations to revise delegations of authority and related provisions to reflect changes in the Commission's internal structure.

DATES: This final rule is effective January 31, 2000.

FOR FURTHER INFORMATION CONTACT: Wilbur Miller, Office of the General Counsel, Federal Energy Regulatory Commission, 888 First Street, N.E., Washington, DC 20426, (202) 208–0953.

SUPPLEMENTARY INFORMATION: In addition to publishing the full text of this document in the **Federal Register**, the Commission provides all interested persons an opportunity to view and/or print the contents of this document via the Internet through FERC's Home Page (*http://www.ferc.fed.us*) and in FERC's Public Reference Room during normal business hours (8:30 a.m. to 5:00 p.m. Eastern time) at 888 First Street, N.E., Room 2A, Washington, DC 20426.

From FERC's Home Page on the Internet, this information is available in both the Commission Issuance Posting System (CIPS) and the Records and Information Management System (RIMS).

—CIPS provides access to the texts of formal documents issued by the Commission since November 14, 1994

—CIPS can be access using the CIPS link or the Energy Information Online icon. The full text of this document will be available on CIPS in ASCII and WordPerfect 8.0 format for viewing, printing, and/or downloading

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Before Commissioners: James J. Hoecker, Chairman; Vicky A. Bailey, William L. Massey, Linda Breathitt, and Curt Hebert, Jr.

I. Introduction

The Federal Energy Regulatory Commission (Commission) is amending 18 CFR Parts 375 and 376 to revise the delegations to certain Commission officials and to make related changes in connection with changes in the Commission's internal structure. These changes came about as a result of the Chairman's FERC First initiative, which reorganized many of the Commission's internal operations with the objective of making them more responsive to the public's needs. As a result, the positions to which the Commission formerly delegated a number of authorities will no longer exist. This rulemaking reassigns those authorities to the new offices.

II. Background

The Commission's staff, at the Chairman's direction, has undertaken a re-engineering effort, called FERC First, to re-examine and, where appropriate, restructure its organization and processes. One result of this effort has been a decision to replace a number of the Commission's internal organizations with others that are better structured to meet the challenges of changing energy markets. Among the new offices that the Commission has established, or is establishing, are the Office of Markets, Tariffs and Rates (OMTR); the Office of Energy Projects (OEP); and the Office of Finance, Accounting and Organization (OFAO). Among the offices being eliminated are the Office of the Chief Accountant, the Office of Pipeline Regulation, the Office of Electric Power Regulation, the Office of Energy Policy, the Office of the Executive Director and the Office of Hydropower Licensing.

III. Discussion

The change in internal structure requires that many of the Commission's delegations of authority be revised to reflect the fact that the positions to which the existing delegations were made, in some cases, have been or are being eliminated. This rulemaking is intended solely to transfer existing delegations rather than to alter the existing scope of delegated authority within the Commission. Apart from the provisions being revised in this rulemaking, there may be other references in the Commission's regulations to official positions or offices that will no longer exist after the reorganization of the Commission's staff. These regulations will be revised in due course. The existing delegations are being revised as follows:

Part 375

Office of the Chief Accountant (existing § 375.303). The Office of the Chief Accountant has been moved into OFAO, with the Chief Accountant reporting to the Director of OFAO.