

relief.<sup>88</sup> After carefully considering these comments, we still believe that general case-by-case exemptions would be neither appropriate nor consistent with the policies and purposes of the Sarbanes-Oxley Act. However, as requested by many commenters,<sup>89</sup> the Commission has exemptive authority to respond to, and will remain sensitive to, evolving standards of corporate governance, including changes in U.S. or foreign law, to address any new conflicts that cannot be anticipated at this time.

### *B. Responsibilities Relating to Registered Public Accounting Firms*

#### 1. Scope of the Requirement

One of the audit committee's primary functions is to enhance the independence of the audit function, thereby furthering the objectivity of financial reporting. The Commission has long recognized the importance of an auditor's independence in the audit process.<sup>90</sup> The auditing process may be compromised when a company's outside auditors view their main responsibility as serving the company's management rather than its full board of directors or its audit committee. This may occur if the auditor views management as its employer with hiring, firing and compensatory powers. Under these conditions, the auditor may not have the appropriate incentive to raise concerns and conduct an objective review. Further, if the auditor does not appear independent to the public, then investor confidence is undermined and one purpose of the audit is frustrated. One way to help promote auditor independence, then, is for the auditor to be hired, evaluated and, if necessary, terminated by the audit committee. This would help to align the auditor's interests with those of shareholders.

Accordingly, we are adopting as proposed the requirement that the audit committee of a listed issuer will need to be directly responsible for the appointment, compensation, retention and oversight of the work of any registered public accounting firm

engaged (including resolution of disagreements between management and the auditor regarding financial reporting) for the purpose of preparing or issuing an audit report or performing other audit, review or attest services for the issuer, and the independent auditor will have to report directly to the audit committee.<sup>91</sup> These oversight responsibilities include the authority to retain the outside auditor, which includes the power not to retain (or to terminate) the outside auditor. In addition, in connection with these oversight responsibilities, the audit committee must have ultimate authority to approve all audit engagement fees and terms.<sup>92</sup>

Overall, commenters supported the requirement as proposed, believing additional specificity is not needed and flexibility should be given to the audit committee regarding the execution of these responsibilities, without rigid rules.<sup>93</sup> A few commenters, however, suggested that we should limit the requirement to cover only certain registered public accounting firms that perform audit, review or attest services for the issuer, that we should limit the coverage of services specified by the proposal, or that we should clearly delineate which oversight responsibilities remain with management.<sup>94</sup> We believe these specific decisions regarding the execution of the audit committee's oversight responsibilities, as well as decisions regarding the extent of desired involvement by the audit committee, are best left to the discretion of the audit committee of the individual issuer in assessing the issuer's individual circumstances. Accordingly, we are not limiting the oversight responsibilities provided by the statute and the proposal.

Some commenters requested further clarification regarding the scope of the services included in the requirement, including "audit, review or attest services." We believe these services encompass the same services covered in the "Audit Fees" category in an issuer's

disclosure of fees paid to its independent public accountants. As discussed in our recent release revising the Commission's auditor independence requirements,<sup>95</sup> this category includes services that normally would be provided by the accountant in connection with statutory and regulatory filings or engagements. In addition to services necessary to perform an audit or review in accordance with Generally Accepted Auditing Standards ("GAAS"),<sup>96</sup> this category also may include services that generally only the independent accountant reasonably can provide, such as comfort letters, statutory audits, attest services, consents and assistance with and review of documents filed with the Commission. This approach does not affect the operation of other Commission rules regarding permissible services or preclude the audit committee from oversight or other involvement in the provision of audit-related or other permissible services.

In the Proposing Release, we requested comment on whether other responsibilities not listed in Exchange Act section 10A(m) should be under the supervision of the audit committee, such as the appointment, compensation, retention and oversight of an issuer's internal auditor. Commenters were split on whether the Commission should mandate oversight responsibility regarding an issuer's internal auditor, with the majority not supporting action by the Commission at this time.<sup>97</sup> Given this split, we are not extending the responsibility requirement to include such oversight.

#### 2. Clarifications Regarding Possible Conflicts With Other Requirements

We proposed adding an instruction to the rule to clarify that the requirements regarding auditor responsibility do not conflict with, and are not affected by, any requirement under an issuer's governing law or documents or other home country requirements that requires shareholders to elect, approve or ratify the selection of the issuer's auditor. The requirements instead relate to the assignment of responsibility to oversee the auditor's work as between the audit committee and management. Commenters welcomed this

<sup>88</sup> Compare, e.g., the Letters of AICPA; CalPERS; CII; CSC; NVCA; the Comptroller of the State of New York; PwC; SWIB, with the Letters of Amex; Deloitte; Ralph S. Saul; S&C.

<sup>89</sup> See, e.g., the Letters of Association of Private French Enterprises—Association of Large French Enterprises ("AFEP-AGREF"); Cleary; Italian Association of Limited Liability Companies ("Assonime"); NYSE.

<sup>90</sup> The federal securities laws 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. 78l(b)(1)(J) and 78m(a)(2)]. See also Title II of the Sarbanes-Oxley Act [Pub. L. 107-204, Title II, 116 Stat. 771-75].

<sup>91</sup> In response to several commenters' questions, we have removed the phrase "or related work" from the final rule where describing the preparation and issuance of an issuer's audit report. We believe the reference to "or other audit, review or attest services" appropriately delineates the intention behind the phrase "or related work."

<sup>92</sup> See also Release No. 33-8183 (Jan. 28, 2003). In response to several commenters' questions, these responsibilities are provided as examples and are not intended to be an exclusive list of responsibilities.

<sup>93</sup> See, e.g., the Letters of AICPA; CalSTRS; Financial Executives Institute ("FEI").

<sup>94</sup> See, e.g., the Letters of Deloitte; Ernst & Young LLP ("E&Y"); PwC; State Street.

<sup>95</sup> See Release No. 33-8183 (Jan. 28, 2003).

<sup>96</sup> See also section 2(a)(2) of the Sarbanes-Oxley Act which defines the term "audit."

<sup>97</sup> Compare, e.g., the Letters of Francisco J. Barragan; Melody Boehl; Marcus B. Elliott; Institute of Internal Auditors; and National Association of Corporate Directors with the Letters of ABA; Canadian Bankers Association ("CBA"); CSC; Deloitte; FEI; C.H. Moore, Jr.; Nasdaq; NYSE; and NYSE.