

respect to the election of directors.²⁰⁵ First, the audit committee must provide a report disclosing whether the audit committee has reviewed and discussed the audited financial statements with management and discussed certain matters with the independent auditors.²⁰⁶ Second, issuers must disclose whether the 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.²⁰⁷ Finally, the issuer must disclose whether the members of the audit committee are independent. Under the existing requirements, 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.²⁰⁸ These issuers also must disclose if its board of directors has determined to appoint one director to its audit committee due to an exceptional and limited circumstances exception in the applicable listing standards.²⁰⁹ Issuers whose securities are not listed on the NYSE or AMEX or quoted on Nasdaq also are required to disclose whether their audit committee members are independent. These issuers may choose which definition of independence to use from any of the NYSE, AMEX or Nasdaq listing standards.²¹⁰

Regarding the independence disclosure, all national securities exchanges and national securities associations under our final rule will need to have independence standards for audit committee members, not just the NYSE, AMEX and Nasdaq. The specification in the existing requirements to listings on these three markets is therefore no longer necessary.

Accordingly, as proposed, we are updating the disclosure requirements regarding the independence of audit committee members to reflect the new SROs rules to be adopted under Exchange Act rule 10A-3. Commenters supported these updates.²¹¹ If the

registrant is a listed issuer, it will still be required to disclose whether the members of its audit committee are independent. The listed issuer must use the definition of independence for audit committee members included in the listing standards applicable to the listed issuer. Further, because the Exchange Act now provides that in the absence of an audit committee the entire board of directors will be considered to be the audit committee, we are clarifying in the rules that if the registrant does not have a separately designated audit committee, or committee performing similar functions, the registrant must provide the disclosure with respect to all members of its board of directors.

Non-listed issuers that have separately designated audit committees will still be required to disclose whether their audit committee members are independent. In determining whether a member is independent, these registrants will be allowed to choose any definition for audit committee member independence of a national securities exchange or national securities association that has been approved by the Commission.²¹²

In the Proposing Release, we proposed eliminating disclosure by listed issuers of use of an exceptional and limited circumstances exception in existing SRO listing standards. We did so because our rules do not provide a similar exception to the independence requirements mandated by Exchange Act rule 10A-3. However, it is conceivable that some SROs may retain an exceptional and limited circumstances exception for SRO independence requirements apart from those in Exchange Act rule 10A-3. We are therefore retaining disclosure of the use of such an exemption for standards apart from the requirements in Exchange Act rule 10A-3. We also are eliminating the exclusion of small business issuers from this disclosure requirement, as it is conceivable that such an exception could extend to these issuers as well.

Issuers must comply with the new disclosure changes regarding use of exemptions, identification of the audit committee in annual reports and the independence disclosure updates beginning with reports covering periods ending on or after (or proxy or information statements for actions occurring on or after) the compliance date for the listing standards applicable

to the particular issuer. If the issuer is not a listed-issuer, it should use the date that would apply as if it was a listed issuer. Until such dates, issuers should continue to comply with existing Items 7(d)(3)(iv) and 22(b)(14) in their proxy and information statements, if applicable.

Several commenters advocated additional disclosure regarding a board's determination of an audit committee member's independence apart from that currently required.²¹³ Several of the additional SRO listing standards currently under consideration by the Commission would require such disclosure by listed issuers.²¹⁴ We intend to analyze these proposals and the SRO rules implementing Exchange Act 10A-3 to determine if any additional disclosure in this area would be appropriate.

4. Audit Committee Financial Expert Disclosure for Foreign Private Issuers

In our release adopting the disclosure requirements for audit committee financial experts, we expressed our intention to revisit the disclosure requirements regarding the independence of audit committee financial experts of foreign private issuers.²¹⁵ Specifically, we noted that in conjunction with the adoption of rules implementing Exchange Act section 10A(m), we would revise the audit committee financial expert disclosure requirements that apply to foreign private issuers such that the concept of "independence" under the section 10A(m) rules would be consistent with the concept of "independence" under the audit committee financial expert disclosure requirements. Therefore, we are now adopting amendments to the audit committee financial expert disclosure provisions as they apply to foreign private issuers. If the foreign private issuer is a listed issuer, the amendments require the foreign private issuer to disclose whether its audit committee financial expert is independent, as that term is defined by the SRO listing standards applicable to that issuer.²¹⁶ If a foreign private issuer is not a listed issuer, it must choose one of the SRO definitions of audit committee member independence that have been approved by the Commission

²⁰⁵ See Item 7(d)(3) of Schedule 14A. These disclosure requirements were adopted in Release No. 34-42266 (Dec. 22, 1999).

²⁰⁶ See Item 7(d)(3)(i) of Schedule 14A. The requirements for the audit committee report are specified in Items 306 of Regulations S-B [17 CFR 228.306] and S-K [17 CFR 229.306]. Under the existing requirements, if the company does not have an audit committee, the board committee tasked with similar responsibilities, or the full board of directors, is responsible for the disclosure.

²⁰⁷ See Items 7(d)(3)(ii) and (iii) of Schedule 14A.

²⁰⁸ See Item 7(d)(3)(iv)(A)(1) of Schedule 14A.

²⁰⁹ See Item 7(d)(3)(iv)(A)(2) of Schedule 14A.

²¹⁰ See Item 7(d)(3)(iv)(B) of Schedule 14A. Whichever definition is chosen must be applied consistently to all members of the audit committee.

²¹¹ See, e.g., the Letters of ABA; CalPERS; CSC; PwC.

²¹² Such definition must include the requirements of Exchange Act section 10A-3. These issuers will still be required to state which definition was used. Further, the requirement that the same definition must be applied consistently to all members of the audit committee will be retained.

²¹³ See, e.g., the Letters of AFL-CIO; AICPA; Amex; Deloitte; PwC; Transparency International-USA. However, for commenters that did not support such expanded disclosure, see, e.g., the Letters of ABA; Southern Company.

²¹⁴ See note 27 above.

²¹⁵ See Release No. 33-8177 (Jan. 23, 2003).

²¹⁶ See revised Item 16A of Form 20-F and revised paragraph 8 to General Instruction B of Form 40-F.