

in determining whether its audit committee financial expert, if it has one, is independent. It must also disclose which definition was used. Foreign private issuers need not comply with these disclosure requirements until July 31, 2005.

Also in that release, we noted our intention to address the treatment of a foreign private issuer with a board of auditors or statutory auditors under home country legal or listing provisions. Specifically, we requested comment as to whether and, if so, how foreign private issuers with boards of auditors or similar bodies or statutory auditors should comply with the audit committee financial expert disclosure requirements. We received several comments both supporting and opposing application of such disclosure requirements to issuers with such bodies. One commenter suggested that the audit committee financial expert's expertise should be related to home country generally accepted accounting principles ("GAAP"), even if the issuer's primary financial statements are filed with the Commission in conformity with U.S. GAAP. We believe that the intent of section 407 of Sarbanes-Oxley Act is to strengthen audit committee oversight of the preparation and audit of financial statements that are presented to U.S. investors, and thus we continue to believe that the audit committee financial expert's expertise should be related to the body of generally accepted accounting principles used in the issuer's primary financial statements filed with the Commission. We do, however, acknowledge the differing regulatory structures of foreign jurisdictions. Therefore, we have added a sentence to the instructions to the audit committee financial expert disclosure provisions to clarify that, for purposes of those provisions, the term "audit committee" means the board of auditors or similar bodies or statutory auditors, if the issuer meets the criteria specified in new rule 10A-3(c)(3).<sup>217</sup>

#### H. Application to the Commission's Auditor Independence Rules

Similar to the issues addressed by the multiple listing exception discussed in section II.F.2.a, some commenters raised an issue with respect to the audit committee pre-approval requirements contained in the Commission's auditor independence rules.<sup>218</sup> Those rules require that the issuer's audit committee

pre-approve audit and non-audit services provided to the issuer and its consolidated subsidiaries<sup>219</sup> by the independent accountant. However, to the extent that a consolidated entity contains more than one issuer, some have indicated that it is not clear whether the parent company audit committee's pre-approval of the services to be provided by the independent accountant would satisfy the pre-approval requirements for the separately-issued financial statements of a subsidiary which also is an issuer.<sup>220</sup>

The Commission believes that the audit committee of the parent company that controls another entity within the consolidated group can perform the pre-approval function for the parent company and any consolidated subsidiaries both with respect to the consolidated financial statements and with respect to the financial statements of any consolidated subsidiary that also is an issuer. However, the Commission also understands that there may be instances where such entities have their own audit committees. In those situations, we would not expect that both audit committees be responsible for pre-approving the services that are provided by the auditor. Rather, the relevant facts and circumstances surrounding the engagement or relationship should be evaluated to determine which audit committee is in the best position to review the impact of the service on the auditor's independence.

As noted at the beginning of section II, the definition of the term "audit committee" in Exchange Act section 3(a)(58) provides that an issuer either may have a separately designated audit committee composed of members of its board, or if it chooses to do so or if it fails to form a separate committee, the entire board of directors will constitute the audit committee.<sup>221</sup> Moreover, as discussed in section II.F.3.a.vi, certain foreign jurisdictions permit many of the functions normally performed by audit committees to be performed by a board of auditors or similar body which is separate in whole or in part from the issuer's board of directors.

In either of these situations, commenters have asked how issuers should comply with the audit committee pre-approval requirements

established by the Commission in its rules on auditor independence. While the Commission's rules on auditor independence require that the audit committee pre-approve audit and non-audit services provided by the independent accountant, those rules do not require that companies establish separately-designated audit committees. If an issuer chooses to do so or fails to form a separate committee, the entire board of directors will constitute the audit committee and may perform the pre-approval function for the issuer.<sup>222</sup> Furthermore, consistent with the intent of Exchange Act rule 10A-3(c)(3), in situations where the issuer has a board of auditors or similar body as allowed by law or listing requirements of that jurisdiction, such board or body may perform the audit committee pre-approval function required by the Commission's rules on auditor independence.

The Commission also reminds registrants and their auditors that the Commission's rules require that auditors communicate certain information to the audit committee.<sup>223</sup> The same body responsible for pre-approval of audit and non-audit services also should be the body to whom these required communications are made by the issuer's auditor.

### III. Paperwork Reduction Act

#### A. Background

The amendments described in this document contain "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 ("PRA").<sup>224</sup> We published a notice requesting comment on the collection of information requirements in the Proposing Release, and we submitted these requirements to the Office of Management and Budget ("OMB") for review in accordance with the PRA.<sup>225</sup> As discussed in Part II

<sup>222</sup> However, as previously discussed, if the issuer is a listed issuer and its entire board constitutes the audit committee, the new SRO rules adopted under Exchange Act Rule 10A-3, including the independence requirements, will apply to the issuer's board as a whole. See note 34 above and the accompanying text.

<sup>223</sup> Auditors are required to communicate the following information to the issuer's audit committee: (1) All critical accounting policies and practices used by the issuer, (2) all alternative accounting treatments of financial information within GAAP related to material items that have been discussed with management, including the ramifications of the use of such alternative treatments and disclosures and the treatment preferred by the accounting firm, and (3) other material written communications between the accounting firm and management of the issuer. See Rule 2-07 of Regulation S-X [17 CFR 210.2-07].

<sup>224</sup> 44 U.S.C. 3501 *et seq.*

<sup>225</sup> 44 U.S.C. 3507(d) and 5 CFR 1320.11.

<sup>217</sup> See revised Instruction 3 to Item 401(h) of Regulation S-K and revised Instruction 3 to Item 16A of Form 20-F.

<sup>218</sup> See Release No. 33-8183 (Jan. 28, 2003).

<sup>219</sup> In accordance with the Commission's rules on auditor independence, the issuer's audit committee is required to pre-approve audit and non-audit services for the issuer and all of its consolidated subsidiaries whether those subsidiaries are separate issuers or not.

<sup>220</sup> For example, some entities may be issuers as a result of registered debt outstanding.

<sup>221</sup> See note above and the accompanying text.