

Oxley Act.<sup>247</sup> They seek to help achieve the Act's goals by promoting strong, effective audit committees to perform their oversight role. By increasing the competence of audit committees, the amendments are designed to further greater accountability and to improve the quality of financial disclosure and oversight of the process by qualified and independent audit committees. Vigilant and informed oversight by a strong, effective and independent audit committee could help to counterbalance pressures to misreport results and impose increased discipline on the process of preparing financial information. Improved oversight may help detect fraudulent financial reporting earlier and perhaps thus deter it or minimize its effects. All of these benefits imply increased market efficiency due to improved information and investor confidence in the reliability of a company's financial disclosure and system of internal controls. These benefits are not readily quantifiable. Commenters overwhelmingly supported the benefits of the amendments and the importance of audit committees to the financial reporting process. Further, as the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees summarized regarding its own recommendations for audit committees:

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.<sup>248</sup>

In addition, we are requiring basic information about the composition of an issuer's audit committee in a listed issuer's annual report. The disclosure is currently only required in proxy or information statements where directors are being elected, and not all listed issuers are subject to the proxy rules or elect directors each year. Also, 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 requiring a listed issuer that has not or has chosen not to separately designate an audit committee to disclose that the entire board of directors is

acting as the issuer's audit committee. Also, if a company relies on one of the exemptions to the requirements, some minimal additional disclosure will be required. In our final rules, we are excluding certain issuers from these disclosure requirements to reduce overall burdens consistent with investor protection. We also are making several updates to existing disclosure requirements regarding audit committees and audit committee financial experts to reflect the final rule and changes made by the Sarbanes-Oxley Act.

As a result of these disclosure changes, investors will receive more detailed information on a consistent basis about the basic composition of an issuer's audit committee. These disclosures will afford investors greater visibility about the issuer's audit committee. Providing this information on a more widespread basis also may allow investors to ask more direct and useful questions of management and directors regarding the composition and role of the audit committee. The overwhelming majority of commenters, including many representing investor groups, expressed strong support for the changes, believing they provide important information for investors.

### C. Costs

SROs not in compliance with the standards will need to spend additional time and incur additional costs in modifying their rules to comply. There also may be ongoing costs in monitoring compliance with the standards and taking appropriate remedial steps. If the standards have the effect of causing companies to delist or forego listing of their securities, SROs will lose trading volume. The standards could have the effect of discouraging the formation of trading markets that specialize in particular types of issuers (*i.e.*, small issuers or foreign issuers), if those issuers found the requirements too burdensome to seek a listing on those markets. The possibility of these effects and their magnitude if they were to occur are difficult to quantify.

Issuers will need to comply with the audit committee standards if they wish to have their securities listed on a national securities exchange or national securities association. This may require one-time costs by companies to spend additional time and incur additional costs in establishing or modifying their audit committees (or full boards if they do not have a separate audit committee) to comply with the standards. There may be search costs involved in locating independent directors willing to serve on a company's audit committee,

including the costs of preparing proxy statements and holding shareholder meetings to elect those directors. If the requirements reduce the pool of candidates that will be willing to serve on an issuer's audit committee, these search costs may increase. Convincing directors to serve on an audit committee may require additional compensation or increased liability insurance coverage due to the new requirements imposed on audit committees. Companies may decide to increase the size of their boards to accommodate new directors meeting the new requirements. If additional independent directors were added to the board, or if existing non-independent directors are replaced, this may increase the percentage of the board that is independent from management. If a company had previously received services from an audit committee member of the type that will be prohibited under the final rule, the company may incur costs in locating an alternative provider for these services.

There also may be ongoing costs in monitoring compliance with the standards or maintaining any additional procedures established by the standards, such as the procedures for handling complaints. To the extent the audit committee incurs expenses or engages independent counsel or other advisors where it could not do so previously, there will be additional costs for the payment for such expenses and advisors. Companies also may incur additional ongoing expenses if they decide to increase the size of their boards in response to the requirements. In addition, the incremental cost of future director searches to replace an audit committee member may likely be higher as a result of the additional independence requirements.

We believe that as a result of many current SRO listing standards,<sup>249</sup> the Commission's audit committee disclosure requirements adopted in 1999,<sup>250</sup> the prior disclosures related to the involvement of the audit committee in recommending or approving changes in auditors and the resolution of disagreements between management and the auditors,<sup>251</sup> and professional standards that require communications between the auditor and audit committees on auditor independence issues,<sup>252</sup> many companies currently

<sup>249</sup> See note 24 above.

<sup>250</sup> See note 25 above.

<sup>251</sup> See, *e.g.*, Item 4 of Form 8-K [17 CFR 249.308] and Item 304 of Regulation S-K [17 CFR 229.304].

<sup>252</sup> See, *e.g.*, AICPA, "Communications with Audit Committees," Statements of Auditing Standards ("SAS") 61, as amended by SAS 89 and

<sup>247</sup> See note above.

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