

need to spend additional time and incur additional costs in modifying their audit committees or board to comply with the standards. Small entities may face particular difficulties in recruiting directors that meet the independence requirements.

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 of these expenses and advisors. Due to the small size of these small entities, these additional costs may have a larger proportional impact on these entities than larger listed issuers.

In addition, the small entity may need to make additional disclosure about its audit committee in its annual report as well as its proxy or information statement if directors are being elected. This may require additional costs in order to collect, record and report the information to be disclosed under the rules. Small entities subject to the proxy rules are already required to disclose most of the information affected by our amendments in proxy or information statements where directors are being elected. This information should be readily available to small entities. Further, the disclosure regarding any exemption from the listing standards should entail only a minimal additional statement.

We have little data to determine how many small entities do not already comply with the final rules and amendments or how much it would cost to comply. We recognize that because the amendments apply only to listed issuers, the quantitative listing standards applicable to listed securities, such as minimum revenue, market capitalization and shareholder equity requirements, will limit the size and number of issuers that will be affected by the requirements.

#### *E. Agency Action To Minimize Effect on Small Entities*

The Regulatory Flexibility Act directs us to consider significant alternatives that would accomplish our stated objectives, while minimizing any significant adverse impact on small entities. In connection with the amendments, we considered the following alternatives:

- Establishing different compliance or reporting requirements or timetables that take into account the resources available to small entities;

- Clarifying, consolidating or simplifying compliance and reporting requirements under the rules for small entities;

- Using performance rather than design standards; and
- Exempting small entities from all or part of the requirements.

The coverage of section 10A(m) of the Exchange Act, as added by Congress in section 301 of the Sarbanes-Oxley Act, makes no distinction based on an issuer's size. We think that improvements in the financial reporting process for listed issuers of all sizes are important for promoting investor confidence in our markets. For example, a 1999 report commissioned by the organizations that sponsored the Treadway Commission found that the incidence of financial fraud was greater in small companies.<sup>267</sup> However, we are sensitive to the costs and burdens that will be faced by small entities. We have endeavored through the amendments to alleviate the regulatory burden on all listed issuers, including the small proportion of small entities that will be affected, while meeting our regulatory objectives.

We believe that a blanket exemption for small entities from coverage of the requirements is not appropriate and inconsistent with the policies underlying the Sarbanes-Oxley Act. Similarly, we believe that different compliance requirements for small entities also would interfere with achieving the primary goal of the amendments to increase the competency and effectiveness of audit committees for all companies with listed securities. The majority of commenters generally agreed with this approach and did not support lesser standards for smaller issuers overall. These commenters did not believe the requirements will impose a disproportionate burden on small issuers. We recognize that because the requirements apply only to listed issuers, the quantitative listing standards applicable to listed securities, such as minimum revenue, market capitalization and shareholder equity requirements, already serve somewhat as a limit on the size of issuers that will be affected by the requirements.

Other commenters, however, were concerned that smaller issuers may have particular difficulty locating qualified audit committee candidates that will meet the independence criteria, especially given the implementation period proposed by the Commission. While these commenters advocated various approaches, such as an exceptional and limited circumstances

exemption for smaller issuers or SRO authority to exempt individual small issuers on a case-by-case basis, most agreed that an additional implementation period would be appropriate for these issuers. We are sensitive to the possible implication for smaller issuers and for SROs that would like to specialize in securities of these issuers. The final rule provides an extended compliance period for listed issuers that are small business issuers. In addition, the modifications to several of the other exemptions in the final rule, such as the overlapping board exemption and the new issuer exemption, should provide additional flexibility to small and new issuers in meeting the requirements of the rule. Our approach of not mandating specific procedures for the auditor responsibility requirement and the complaint procedures requirement should give issuers additional flexibility in meeting these requirements. Given the fact that the requirements will impact such a small number of small entities, we are not aware of how to further clarify, consolidate or simplify these amendments for small entities.

The amendments use performance standards in a number of respects. As noted above, we are not specifying the specific procedures or arrangements an issuer or audit committee must develop to comply with the standards. We do provide design standards regarding audit committee member independence, as these are the standards we are directed to implement by Congress. Accordingly, we believe that design standards are necessary to achieve the objectives of the statutory mandate. We do have the authority under section 10A(m)(3)(C) to exempt particular relationships with respect to audit committee members, although, for the reasons discussed above, we are not using that authority at this time for small entities.

#### **VII. Effective Date**

The final rules and amendments are effective on April 25, 2003. The Administrative Procedure Act, or APA, generally requires that an agency publish an adopted rule in the **Federal Register** 30 days before it becomes effective.<sup>268</sup> This requirement, however, does not apply if the agency finds good cause for making the rule effective sooner.<sup>269</sup> The Commission believes that it is appropriate to waive the full 30-day advance publication of the new rule and amendments. The Sarbanes-Oxley Act requires the rules to be

<sup>268</sup> 5 U.S.C. 553(d).

<sup>269</sup> *Id.*

<sup>267</sup> See note above.