

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 228, 229, 240, 249 and 274

[Release Nos. 33–8173; 34–47137; IC–25885; File No. S7–02–03]

RIN 3235–AI75

Standards Relating to Listed Company Audit Committees

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: As directed by the Sarbanes-Oxley Act of 2002, we are proposing a new rule to direct the national securities exchanges and national securities associations to prohibit the listing of any security of an issuer that is not in compliance with the audit committee requirements established by the Sarbanes-Oxley Act of 2002. These requirements relate to: the independence of audit committee members; the audit committee's responsibility to select and oversee the issuer's independent accountant; procedures for handling complaints regarding the issuer's accounting practices; the authority of the audit committee to engage advisors; and funding for the independent auditor and any outside advisors engaged by the audit committee. The new rule must become effective by April 26, 2003, and under our proposals, the new requirements would need to be operative by the national securities exchanges and national securities associations no later than the first anniversary of the publication of our final rule in the **Federal Register**. The proposals would implement the requirements of Section 10A(m)(1) of the Securities Exchange Act of 1934, as added by Section 301 of the Sarbanes-Oxley Act of 2002.

DATES: Comments should be received on or before February 18, 2003.

ADDRESSES: To help us process and review your comments more efficiently, comments should be sent by hard copy or e-mail, but not by both methods. Comments sent by hard copy should be submitted in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–0609. Comments also may be submitted electronically at the following electronic mail address: rule-comments@sec.gov. All comment letters should refer to File No. S7–02–03. This file number should be included in the subject line if electronic mail is used. Comment letters

will be available for public inspection and copying in the Commission's Public Reference Room, 450 Fifth Street, NW., Washington, DC 20549. Electronically submitted comment letters will be posted on the Commission's Internet Web site (<http://www.sec.gov>).¹

FOR FURTHER INFORMATION CONTACT:

Jeffrey J. Minton, Special Counsel, or Elizabeth M. Murphy, Chief, Office of Rulemaking, Division of Corporation Finance, at (202) 942–2910, or, with respect to investment companies, Christopher P. Kaiser, Senior Counsel, Office of Disclosure Regulation, Division of Investment Management, at (202) 942–0724, U.S. Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549.

SUPPLEMENTARY INFORMATION: We are proposing to add new Rule 10A–3² under the Securities Exchange Act of 1934 (the “Exchange Act”),³ to amend Forms 10–K,⁴ 10–KSB,⁵ 20–F⁶ and 40–F⁷ and Items 7 and 22 of Schedule 14A⁸ under the Exchange Act, to amend Item 401⁹ of Regulation S–B¹⁰ and Items 401¹¹ and 601¹² of Regulation S–K¹³ under the Securities Act of 1933 (the “Securities Act”),¹⁴ and to amend proposed Form N–CSR¹⁵ under the Exchange Act and the Investment Company Act of 1940 (the “Investment Company Act”).¹⁶

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¹ We do not edit personal identifying information, such as names or electronic mail addresses, from electronic submissions. You should submit only information that you wish to make available publicly.

² 17 CFR 240.10A–3.

³ 15 U.S.C. 78a *et seq.*

⁴ 17 CFR 249.310.

⁵ 17 CFR 249.310b.

⁶ 17 CFR 249.220f.

⁷ 17 CFR 249.240f.

⁸ 17 CFR 240.14a–101.

⁹ 17 CFR 228.401.

¹⁰ 17 CFR 228.10 *et seq.*

¹¹ 17 CFR 229.401.

¹² 17 CFR 229.601.

¹³ 17 CFR 229.10 *et seq.*

¹⁴ 15 U.S.C. 77a *et seq.*

¹⁵ 17 CFR 249.331 and 17 CFR 274.128.

¹⁶ 15 U.S.C. 80a–1 *et seq.*

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I. Background and Overview of the Proposals

Accurate and reliable financial reporting lies at the heart of our disclosure-based system for securities regulation, and is critical to the integrity of the U.S. securities markets. Investors need accurate and reliable financial information to make informed investment decisions. Investor confidence in the reliability of corporate financial information is fundamental to the liquidity and vibrancy of our markets.

Effective oversight of the financial reporting process is fundamental to preserving the integrity of our markets. The board of directors, elected by and accountable to shareholders, is the focal point of the corporate governance system. The audit committee, composed of members of the board of directors, plays a critical role in serving as a check and balance on a company's financial reporting system. The audit committee provides independent review and oversight of a company's financial reporting processes, internal controls and independent auditors. It provides a forum separate from management in which auditors and other interested parties can candidly discuss concerns. By effectively carrying out its functions and responsibilities, the audit committee helps to ensure that management properly develops and adheres to a sound system of internal controls, that procedures are in place to objectively assess management's practices and internal controls, and that the outside auditors, through their own review, objectively assess the company's financial reporting practices.

Since the early 1940s, the Commission, along with the auditing