

and corporate communities, has had a continuing interest in promoting effective and independent audit committees.¹⁷ It was largely with the Commission's encouragement, for instance, that the self-regulatory organizations, or SROs, first adopted audit committee requirements in the 1970s.¹⁸ Over the years, others have expressed support for strong, independent audit committees,¹⁹ including the National Commission on Fraudulent Financial Reporting, also known as the Treadway Commission,²⁰ and the General Accounting Office.²¹

In 1998, the New York Stock Exchange (the "NYSE") and the National Association of Securities Dealers, Inc. (the "NASD") sponsored a committee to study the effectiveness of audit committees. This committee became known as the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees (the "Blue Ribbon Committee"). In its 1999 report, the Blue Ribbon Committee recognized the importance of audit committees and issued ten recommendations to improve their effectiveness.²² In response to these recommendations, the NYSE and the NASD, among others, revised their listing standards relating to audit

committees,²³ and we adopted new rules requiring disclosure relating to the functioning, governance and independence of corporate audit committees.²⁴ Earlier this year, at the Commission's request,²⁵ the NYSE and the NASD again reviewed their corporate governance standards, including their audit committee rules, in light of several high-profile corporate failures, and have proposed changes to their rules to provide more demanding standards for audit committees.²⁶

Recent events involving alleged misdeeds by corporate executives and independent auditors have damaged investor confidence in the financial markets.²⁷ They have highlighted the need for strong, competent and vigilant audit committees with real authority.²⁸ In response to the threat to the U.S. financial markets posed by these events, Congress passed, and the President signed into law on July 30, 2002, the Sarbanes-Oxley Act of 2002 (the "Sarbanes-Oxley Act").²⁹ The Sarbanes-Oxley Act mandates sweeping corporate disclosure and financial reporting reform to improve the responsibility of public companies for their financial disclosures. This release is one of several that we are issuing to implement provisions of the Sarbanes-Oxley Act.³⁰

¹⁷ In 1940, the Commission investigated the auditing practices of McKesson & Robbins, Inc., and the Commission's ensuing report prompted action on auditing procedures by the auditing community. *In the Matter of McKesson & Robbins*, Accounting Series Release (ASR) No. 19, Exchange Act Release No. 2707 (Dec. 5, 1940).

¹⁸ For example, in 1972, the Commission recommended that companies establish audit committees composed of outside directors. See ASR 123 (Mar. 23, 1972). In 1974 and 1978, the Commission adopted rules requiring disclosures about audit committees. See Release No. 34-11147 (Dec. 20, 1974) and Release No. 34-15384 (Dec. 6, 1978).

¹⁹ See, e.g., Preliminary Report of the American Bar Association Task Force on Corporate Responsibility (July 16, 2002). The report is available on the American Bar Association's website at www.abanet.org/buslaw/.

²⁰ The Treadway Commission was sponsored by the American Institute of Certified Public Accountants, the American Accounting Association, the Financial Executives Institute (now Financial Executives International), the Institute of Internal Auditors and the National Association of Accountants. Collectively, these groups were known as the Committee of Sponsoring Organizations, or COSO. The Treadway Commission's report, the Report of the National Commission on Fraudulent Financial Reporting (October 1987), is available at www.coso.org.

²¹ GAO, "CPA Audit Quality: Status of Actions Taken to Improve Auditing and Financial Reporting of Public Companies," at 5 (GAO/AFMD-89-38, March 1989).

²² See Report and Recommendations of the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees (February 1999). The Blue Ribbon Committee Report is available at www.nyse.com.

²³ See, for example, Exchange Act Release No. 42231 (Dec. 14, 1999) [64 FR 71523] (Nasdaq rules) and Exchange Act Release No. 42233 (Dec. 14, 1999) (NYSE rules) [64 FR 71529]. See also Exchange Act Release No. 42232 (Dec. 14, 1999) [64 FR 71518] (American Stock Exchange rules) and Release No. 34-43941 (Feb. 7, 2001) [66 FR 10545] (Pacific Exchange rules).

²⁴ See Exchange Act Release No. 42266 (Dec. 22, 1999) [64 FR 73389].

²⁵ See Press Release No. 2002-23 (Feb. 13, 2002).

²⁶ See File Nos. SR-NASD-2002-141 and SR-NYSE-2002-33 (pending before the Commission).

²⁷ See, for example, John Waggoner and Thomas A. Fogarty, "Scandals Shred Investors' Faith: Because of Enron, Andersen and Rising Gas Prices, the Public is More Wary Than Ever of Corporate America," USA Today, May 5, 2002; and Louis Aguilar, "Scandals Jolting Faith of Investors," Denver Post, June 27, 2002.

²⁸ See, for example, John Good, "After Enron, Beef Up Those Audit Committees," The Commercial Appeal, Apr. 26, 2002; and "FT Comment After Enron: Giving Meaning to the Codes of Best Practice: Corporate Governance: Companies Need Truly Independent Directors, Strong Audit Committees, an Outlet for Whistleblowers and Tight Controls on Share Options," The Financial Times, Feb. 19, 2002.

²⁹ Pub. L. 107-204, 116 Stat. 745 (2002).

³⁰ For example, see Release No. 34-46421 (Aug. 27, 2002) [67 FR 56462] (Ownership reports and trading by officers, directors and principal security holders); Release No. 33-8124 (Aug. 28, 2002) [67 FR 57276] (Certification of disclosure in companies' quarterly and annual reports); Release No. 33-46685 (Oct. 18, 2002) [67 FR 65325] (Improper influence on conduct of audits); Release No. 33-8138 (Oct. 22, 2002) [67 FR 66208] (Disclosure regarding internal control reports, audit committee financial experts and company codes of ethics); Release No. 33-8144 (Nov. 4, 2002) [67 FR 68054]

In this release, we propose to implement Section 10A(m)(1) of the Exchange Act,³¹ as added by Section 301 of the Sarbanes-Oxley Act, which requires us to direct, by rule, the national securities exchanges³² and national securities associations³³ to prohibit the listing of any security of an issuer that is not in compliance with several enumerated standards regarding issuer audit committees. The new rule must become effective by April 26, 2003, which is 270 days after the date of enactment of the Sarbanes-Oxley Act and Section 10A(m) of the Exchange Act.³⁴ Under our proposals, the new requirements would need to be operative by the SROs no later than the first anniversary of the publication of our final rule in the **Federal Register**. In addition, our proposals would make

(Disclosure about off-balance sheet arrangements, contractual obligations and contingent liabilities and commitments); Release No. 33-8145 (Nov. 4, 2002) [67 FR 68790] (Conditions for use of non-GAAP financial information); Release No. 34-46778 (Nov. 6, 2002) [67 FR 69430] (Insider trades during pension plan blackout periods); Release No. 33-8150 (Nov. 21, 2002) [67 FR 71670] (Implementation of standards of conduct for attorneys); Release No. 33-8151 (Nov. 21, 2002) [67 FR 71018] (Retention of records relevant to audits and reviews); Release No. 33-8154 (Dec. 2, 2002) [67 FR 76780] (Strengthening the Commission's requirements regarding auditor independence); and Release No. 33-8170 (Dec. 20, 2002) [67 FR 79466] (Mandated electronic filing and website posting for Forms 3, 4 and 5).

³¹ 15 U.S.C. 78j-1(m)(1).

³² A "national securities exchange" is an exchange registered as such under Section 6 of the Exchange Act (15 U.S.C. 78f). There are currently nine national securities exchanges registered under Section 6(a) of the Exchange Act: American Stock Exchange (AMEX), Boston Stock Exchange, Chicago Board Options Exchange (CBOE), Chicago Stock Exchange, Cincinnati Stock Exchange, International Securities Exchange, New York Stock Exchange (NYSE), Philadelphia Stock Exchange and Pacific Exchange. In addition, an exchange that lists or trades security futures products (as defined in Exchange Act Section 3(a)(56) (15 U.S.C. 78c(56))) may register as a national securities exchange under Section 6(g) of the Exchange Act solely for the purpose of trading security futures products. Regarding security futures products, see Section II.F.2.b.

³³ A "national securities association" is an association of brokers and dealers registered as such under Section 15A of the Exchange Act (15 U.S.C. 78o-3). The National Association of Securities Dealers (NASD) is the only national securities association registered with the Commission under Section 15A(a) of the Exchange Act. The NASD partially owns and operates The Nasdaq Stock Market (Nasdaq). Nasdaq has filed an application with the Commission to register as a national securities exchange. In addition, Section 15A(k) of the Exchange Act (15 U.S.C. 78o-3(k)) provides that a futures association registered under Section 17 of the Commodity Exchange Act (7 U.S.C. 21) shall be registered as a national securities association for the limited purpose of regulating the activities of members who are registered as broker-dealers in security futures products pursuant to Section 15(b)(11) of the Exchange Act (15 U.S.C. 78o(b)(11)). Regarding security futures products, see Section II.F.2.b.

³⁴ See Exchange Act Section 10A(m)(1)(A).