

generally would remain subject to the proposed requirements regarding audit committee responsibility in all other areas, including compensation and oversight of the auditors.⁶⁵

Questions regarding the proposed auditor responsibility requirement:

- We request comment on implementation of this proposed requirement. Is additional specificity needed?
- Should the audit committee also be directly responsible for the appointment, compensation, retention and oversight of an issuer's internal auditor? Should other responsibilities be under the supervision of the audit committee?
- Does the proposed instruction that the requirement does not conflict with, and is not affected by, any requirement that requires shareholders to ultimately elect, approve or ratify the selection of the issuer's auditor adequately address the concerns of issuers whose governing law or documents requires shareholder selection of the auditor? Are additional accommodations necessary? Please explain how any accommodation would be consistent with the Sarbanes-Oxley Act.
- Should the requirements relating to independent auditor selection of Section 32(a) of the Investment Company Act be retained with respect to registered investment companies falling within the scope of the proposed rule? If so, why? Should the Commission instead exempt registered investment companies from the requirements relating to independent auditor selection in Section 32(a) of the Investment Company Act, when such investment companies fall within the scope of the proposed rule, and require

that their independent auditors be selected by the audit committee? If so, why?

- Should the Commission require registered investment companies to comply with the requirements of both Section 32(a) of the Investment Company Act and the proposed rule with respect to the selection of independent auditors? If so, should we interpret these provisions to require that the audit committee nominate the independent auditor and the majority of disinterested directors approve the independent auditor?
- We note that our recent release regarding auditor independence proposes that the audit committee of a registered investment company separately approve the independent auditor.⁶⁶ How should the Commission reconcile proposed Rule 10A-3, the auditor independence proposal, and Section 32(a) of the Investment Company Act?

C. Procedures for Handling Complaints

The audit committee must place some reliance on management for information about the company's financial reporting process. Since the audit committee is dependent to a degree on the information provided to it by management and internal and outside auditors, it is imperative for the committee to cultivate open and effective channels of information. Management may not have the appropriate incentives to self-report all questionable practices. A company employee or other individual may be reticent to report concerns regarding questionable accounting or other matters for fear of management reprisal.⁶⁷ The establishment of formal procedures for receiving and handling complaints could serve to facilitate disclosures, encourage proper individual conduct and alert the audit committee to potential problems before they have serious consequences.

Accordingly, under the standards contemplated by the proposals, each audit committee would need to establish procedures for:⁶⁸

- The receipt, retention and treatment of complaints received by the issuer regarding accounting, internal accounting controls or auditing matters, and

- The confidential, anonymous submission by employees of the issuer of concerns regarding questionable accounting or auditing matters.

We do not propose to mandate specific procedures that the audit committee must establish. Given the variety of listed issuers in the U.S. capital markets, we believe companies should be provided with flexibility to develop and utilize procedures appropriate for their circumstances. We expect each audit committee to develop procedures that work best consistent with its company's individual circumstances.

Questions regarding the proposed complaint procedures requirement:

- Do most listed issuers have procedures for the receipt, retention and treatment of complaints or for the confidential, anonymous submission by employees of concerns regarding questionable accounting or auditing matters? If so, how do these procedures work? Are they effective in their purpose?
- Should the proposed rule require a company to disclose the procedures that have been established or any changes to those procedures? If so, where and how often should the disclosure appear and what should it look like?
- Should specified procedures be prescribed or encouraged? For example, should we specify how long complaints must be retained? Should we specify who could or could not be designated by the audit committee for the receipt and treatment of complaints?

D. Authority To Engage Advisors

To be effective, an audit committee must have the necessary resources and authority to fulfill its function. The audit committee likely is not equipped to self-advise on all accounting, financial reporting or legal matters. To perform its role effectively, therefore, an audit committee may need the authority to engage its own outside advisors, including experts in particular areas of accounting, as it determines necessary apart from counsel or advisors hired by management, especially when potential conflicts of interest with management may be apparent.

The advice of outside advisors may be necessary to identify potential conflicts of interest and assess the company's disclosure and other compliance obligations with an independent and critical eye. Often, outside advisors can draw on their experience and knowledge to identify best practices of other companies that might be appropriate for the issuer. The assistance of outside advisors also may be needed to independently investigate

⁶⁵ Section 32(a) applies to management investment companies and face-amount certificate companies. It does not apply to unit investment trusts, which do not have boards of directors and which we propose to exclude entirely from the requirements that we are proposing. See Section II.F.3.d. concerning unit investment trusts. There are three types of investment companies: face-amount certificate companies, unit investment trusts and management companies. See Section 4 of the Investment Company Act [15 U.S.C. 80a-4]. The Investment Company Act divides management companies into two sub-categories, defining an open-end company as a management company that offers for sale or has outstanding any redeemable securities of which it is the issuer and a closed-end company as any management company other than an open-end company. See Section 5(a) of the Investment Company Act [15 U.S.C. 80a-5(a)]. A unit investment trust is an investment company that is organized under a trust indenture, contract of custodianship or agency, or similar instrument; does not have a board of directors; and issues only redeemable securities, each of which represents an undivided interest in a unit of specified securities, but does not include a voting trust. See Section 4(2) of the Investment Company Act of 1940 [15 U.S.C. 80a-4(2)].

⁶⁶ See Exchange Act Release No. 46934 (Dec. 2, 2002).

⁶⁷ The Sarbanes-Oxley Act provides additional protections for employees who provide evidence of fraud. See, for example, Section 806 of the Sarbanes-Oxley Act.

⁶⁸ The Commission's proposals are not intended to preempt or supersede any other Federal or State requirements relating to receipt and retention of records.