

audit committee to disclose that the entire board of directors is acting as the issuer's audit committee. Also, if a company relied on one of the exemptions we propose to the requirements, some minimal additional disclosure would be required in its proxy or information statements where directors are elected and in their annual report (unless incorporated by reference). We also propose several updates to existing disclosure requirements regarding audit committees to reflect the proposals and changes made by the Sarbanes-Oxley Act.

As a result of these disclosure changes, investors would 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.

### C. Potential Costs

SROs not in compliance with the standards would 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. We request comment on the type, amount and duration of these costs. If the proposed standards had the effect of causing companies to delist or forego listing of their securities, SROs would lose trading volume. The proposed 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 proposed 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 would need to comply with the proposed audit committee standards if they wished to have their securities listed on a national securities exchange or national securities association. This may require companies to spend additional time and incur additional costs in establishing and 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 would 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 proposed requirements. If additional independent directors are 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 would be prohibited under the proposals, 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 engages independent counsel or other advisors where it could not do so previously, there would be additional costs for the payment of compensation to these advisors. Companies also may incur additional ongoing expenses if they decide to increase the size of their boards in response to the requirements.

We believe that as a result of many current SRO listing standards,<sup>141</sup> the Commission's audit committee disclosure requirements adopted in 1999,<sup>142</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>143</sup> and professional standards that require communications between the auditor and audit committees on auditor independence issues,<sup>144</sup> many companies currently have audit committees. However, these audit committees may not meet all of

our proposed requirements. Smaller companies may constitute a larger representative share of issuers that do not meet the proposed requirements, particularly the independence requirements. However, we recognize that because the proposals 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 of issuers that will be affected by the requirements. Companies that do not currently meet our proposed requirements would face all of the costs described above. However, these entities, because they currently lack the protections provided by the standards, may bear a disproportionately greater risk of fraudulent financial reporting, and thus may reap proportionately greater benefits.

We also have proposed limited exemptions to the requirements, such as an exemption for multiple listings, a limited exemption for new public companies and exemptions for certain foreign issuers, to alleviate some of the burdens companies may face where consistent with investor protection. Companies that perceived the proposals as too onerous could be dissuaded from seeking or maintaining a listing for their securities, which could impact capital formation and negatively impact the liquidity for its securities. We have no reliable basis for estimating the number of companies that would face increased costs as a result of the proposals or the amount of such costs.

Regarding the disclosure changes we propose regarding audit committees, issuers subject to the proxy rules are already required to compile most of this information for proxy or information statements where directors are being elected. Foreign private issuers that file their annual reports on Form 20-F also are already required to identify the members of their audit committee. The disclosure regarding if a listed issuer is availing itself of an exemption to the requirements should result in minimal additional disclosure. Using estimates derived from our Paperwork Reduction Act analysis, we estimate that the incremental impact of our proposed disclosure changes will result in a total cost of \$185,225 for all affected companies.<sup>145</sup>

<sup>141</sup> See note 23 above.

<sup>142</sup> See note 24 above.

<sup>143</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>144</sup> See, *e.g.*, American Institute of Certified Public Accountants ("AICPA") "Communications with Audit Committees," Statements of Auditing Standards ("SAS") 61, as amended by SAS 89 and 90; AICPA, Codification of Statements on Auditing Standards ("AU") § 380; Independence Standards Board, "Independence Discussion with Audit Committees," Independence Standard No. 1 (Jan. 1999).

<sup>145</sup> The estimate is based on the burden hour estimates calculated under the Paperwork Reduction Act. For purposes of the Paperwork Reduction Act, we estimate that the additional disclosure will result in 685 internal burden hours and \$99,600 in external costs. Assuming a cost of \$125/hour for in-house professional staff, the total cost for the internal burden hours would be