

proposals? What are the burdens and costs that small entities would face? Would the proposal disproportionately impact small entities? Would the proposals have any effect on the willingness or ability of small entities to seek or maintain a listing for their securities?

E. Duplicative, Overlapping or Conflicting Federal Rules

The rules of several existing SROs contain minimum standards relating to audit committees.¹⁷² To the extent any of these standards are in conflict with our proposals, our proposals would supercede these requirements. SROs would not be precluded from adopting additional listing standards regarding audit committees, as long as they were consistent with the proposed rule. We believe that there are no other rules that duplicate, overlap or conflict with the proposals, except for the inconsistency between proposed Rule 10A-3 and Section 32(a) of the Investment Company Act regarding the selection of auditors. That inconsistency would be resolved if the rule is adopted as proposed.

F. Significant Alternatives

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 our proposals, 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.¹⁷³ However, we are

sensitive to the costs and burdens that would be faced by small entities.

Although we preliminarily believe that an exemption for small entities from coverage of the proposals is not appropriate and inconsistent with the policies underlying the Sarbanes-Oxley Act, we solicit comment on the propriety of a complete or partial exemption from the requirements for small entities. We preliminarily believe that different compliance requirements or timetables for small entities also would interfere with achieving the primary goal of the proposals of increasing the competency and effectiveness of audit committees for all companies with listed securities. In addition, we are not aware of how to further clarify, consolidate or simplify these proposals for small entities. 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, already serve somewhat as a limit on the size of issuers that will be affected by the requirements. We do, however, solicit comment on these views and whether different compliance requirements or timetables for small entities would be appropriate, consistent with the mandate and purposes of Section 10A(m) of the Exchange Act.

The proposals use performance standards in a number of respects. We do not propose to specify the procedures or arrangements an issuer or audit committee must develop to comply with the standards. For example, we do not propose to specify the procedures that an audit committee must establish for handling complaints, as we believe companies should have the flexibility to develop procedures most efficient for their individual circumstances. 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 proposals. 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 do not propose to use that authority at this time for small entities. We request comment on these views.

G. Request for Comments

We encourage the submission of comments with respect to any aspect of this IRFA. In particular, we request

comment on the number of small entities that would be affected by the proposals, the nature of the impact, how to quantify the number of small entities that would be affected, and how to quantify the impact of, the proposals. Commenters are requested to describe the nature of any effect and provide empirical data and other factual support for their views if possible. These comments will be considered in preparing the Final Regulatory Flexibility Analysis, if the proposals are adopted, and will be placed in the same public file as comments on the proposals.

VII. Statutory Authority and Text of Rule Amendments

The proposals contained in this document are being proposed under the authority set forth in Sections 2, 6, 7, 8, 10, 17 and 19 of the Securities Act, Sections 3(b), 10A, 12, 13, 14, 15, 23 and 36 of the Exchange Act, Sections 8, 20, 24(a), 30 and 38 of the Investment Company Act of 1940 and Sections 3 and 301 of the Sarbanes-Oxley Act.

Text of Proposed Amendments

List of Subjects in 17 CFR Parts 228, 229, 240, 249 and 274

Investment companies, Reporting and recordkeeping requirements, Securities.

In accordance with the foregoing, Title 17, Chapter II of the Code of Federal Regulations is proposed to be amended as follows:

PART 228—INTEGRATED DISCLOSURE SYSTEM FOR SMALL BUSINESS ISSUERS

1. The authority citation for Part 228 is amended by adding the following citation in numerical order to read as follows:

Authority: 15 U.S.C. 77e, 77f, 77g, 77h, 77j, 77k, 77s, 77z-2, 77z-3, 77aa(25), 77aa(26), 77ddd, 77eee, 77ggg, 77hhh, 77jjj, 77nnn, 77sss, 78l, 78m, 78n, 78o, 78u-5, 78w, 78ll, 78mm, 80a-8, 80a-29, 80a-30, 80a-37 and 80b-11.

* * * * *

Section 228.401 is also issued under secs. 3(a) and 301, Pub. L. No. 107-204, 116 Stat. 745.

2. Amend § 228.401 by adding paragraph (e) to read as follows:

§ 228.401 (Item 401) Directors, Executive Officers, Promoters and Control Persons.

* * * * *

(e) *Identification of the audit committee.* If you are a listed issuer, as defined in § 240.10A-3 of this chapter, filing an annual report on Form 10-KSB (17 CFR 249.310b) or a proxy statement or information statement pursuant to the

¹⁷² See note 23 above.

¹⁷³ See note 91 above.