

“under the direction of” with “on behalf of” might be construed as narrowing the scope of the rule, and having both phrases in the rule might create confusion in the interpretation of the rule. Accordingly, we have adopted the rule as proposed.

We also asked in the proposing release if we should replace the word “fraudulently” in paragraphs (b)(1) and (c)(2) of the rule with the word “improperly” or some other word to convey a mental state short of scienter. Although some commenters noted that there is a need for the Commission to adopt rules intended to enhance investor confidence in issuers’ financial statements,⁹⁹ commenters generally opposed this change as exceeding the purpose and scope of section 303 of the Act.¹⁰⁰ The new rule retains the statutory language of “fraudulently influence” because we are concerned about a lack of specificity associated with the word “improperly” in the context of the rule. As discussed above, “fraudulently” modifies only influence and not “coerce, manipulate or mislead.”

Finally, commenters questioned whether an auditor would have an obligation to report violations of the new rule as “illegal acts” under section 10A(b) of the Exchange Act.¹⁰¹ Section

10A defines an “illegal act” to be an act or omission that violates any law or any rule or regulation having the force of law.¹⁰² Accordingly, violations of the new rule are illegal acts within section 10A and should be dealt with as required by that section.¹⁰³

C. Issues Related to Investment Companies

In the case of registered investment companies and business development companies,¹⁰⁴ the prohibition on improper influence on the conduct of audits covers not only officers and directors of the investment company itself, but also officers and directors of the investment company’s investment adviser, sponsor, depositor, trustee, and administrator.¹⁰⁵ These service providers perform virtually all of the management, administrative, and other services necessary to the investment company’s operations, including preparation of the financial statements. We are also amending existing rule 13b2–2 to cover officers and directors of these entities.¹⁰⁶

One commenter suggested expanding the scope of the persons covered by the prohibition, to include accounting personnel working for an investment company’s service providers.¹⁰⁷ Consistent with the language of section 303(a) and the scope of the rule for operating companies, we have not expressly included these persons, although we note that they would be covered by the rule if they are acting under the direction of an officer or director of the investment company or its investment adviser, sponsor, depositor, trustee, or administrator. By contrast, another commenter argued that the prohibition should extend to officers and directors of an investment company’s investment adviser, because the investment adviser acts, in effect, in an executive capacity with a fund, but should not extend to other service

providers.¹⁰⁸ We have determined not to narrow the service providers covered by the new rule in this manner, because any of the investment adviser, sponsor, depositor, trustee, or administrator may have responsibility for preparation of an investment company’s financial statements, and therefore its officers and directors may be in a position to exercise improper influence over the investment company’s audit.

III. Paperwork Reduction Act

The Paperwork Reduction Act is not applicable to the rules because they do not impose any collection of information requirements.

IV. Costs and Benefits

The new rules implement a Congressional mandate. We recognize that any implementation of the Act likely will result in costs and benefits and have an effect on the economy. We are sensitive to the costs and benefits imposed by our rules and, in the proposing release, we identified certain costs and benefits of the proposed rule.

The new rules prohibit officers and directors of an issuer, and persons acting under the direction of an officer or director, from taking any action to coerce, manipulate mislead, or fraudulently influence the auditor of the issuer’s financial statements if that person knew or should have known that such action, if successful, could result in rendering the financial statements materially misleading.

Some commenters were concerned that the rules could have a chilling effect on communications between the auditor and third parties,¹⁰⁹ or dampen the debate on accounting issues between auditors and issuers.¹¹⁰ Such a chilling effect on communications between third parties and auditors, or between auditors and the issuer, could result in an added cost associated with the rule. We believe, however, that the conduct addressed by the new rules generally was prohibited under provisions of the securities laws that existed before enactment of the Sarbanes-Oxley Act.¹¹¹

⁹⁹ See, e.g., letter from Association for Investment Management and Research dated December 12, 2002.

¹⁰⁰ See, e.g., letters from Wells Fargo dated November 22, 2002, Eastman Kodak Company received on November 25, 2002, Sullivan & Cromwell dated November 25, 2002, the American Bar Association dated December 13, 2002, The Business Roundtable dated November 29, 2002, America’s Community Bankers dated November 25, 2002, the Software Finance & Tax Executives Council dated November 25, 2002, New York State Bar Association dated November 25, 2002, Independent Community Bankers of America dated November 25, 2002, Plains All American Pipeline LP dated November 25, 2002, Dechert dated November 25, 2002, Intel Corporation dated November 25, 2002, Compass Bancshares Inc. dated November 25, 2002, and Robert Waxman dated November 25, 2002.

¹⁰¹ Letters from KPMG LLP dated November 25, 2002 and PwC dated November 25, 2002. Section 10A(a) of the Exchange Act, 15 U.S.C. 78j–1(a), requires auditors to conduct procedures designed to provide, among other things, reasonable assurance of the detection of illegal acts that would have a direct and material effect on the determination of financial statement amounts. Section 10A(b) of the Exchange Act, 15 U.S.C. 78j–1(b), states that if the accountant becomes aware of information indicating that an illegal act has or may have occurred the accountant shall perform additional procedures to determine whether it is likely an illegal act has occurred and, if so, its possible effect on the financial statements, and report the act to management and assure that the issuer’s audit committee is informed of the act. If the accountant concludes that the illegal act has a material effect on the financial statements, appropriate remedial actions are not taken, and the failure to take such actions is reasonably expected to warrant a modified audit report or resignation from the audit

engagement, then the auditor must report his or her conclusions to the issuer’s board of directors. If the board does not notify the Commission that it has received such a report, then the auditor must furnish to the Commission a copy of its report.

¹⁰² Section 10A(f) of the Exchange Act, 15 U.S.C. 78j–1(f).

¹⁰³ One commenter also suggested “technical corrections” to the rule to include “review” in paragraph (a)(2)(i) and “reissue” in paragraph (b)(2)(i). Letter from KPMG LLP dated November 25, 2002. We have made these corrections and a conforming change to paragraph (c)(1)(ii)(A).

¹⁰⁴ Business development companies are a category of closed-end investment companies that are not required to register under the Investment Company Act of 1940. See 15 U.S.C. § 80a–2(a)(48) (defining business development companies).

¹⁰⁵ Rule 13b2–2(c)(2).

¹⁰⁶ Rule 13b2–2(c)(1).

¹⁰⁷ Letter from PwC dated November 25, 2002.

¹⁰⁸ Letter from Dechert dated November 25, 2002.

¹⁰⁹ See, e.g., letters from Wells Fargo dated November 22, 2002, Dorsey & Whitney dated November 25, 2002, Deloitte & Touche dated November 27, 2002, Sidley Austin Brown & Wood dated December 30, 2002, America’s Community Bankers dated November 25, 2002, and BDO Seidman LLP dated November 25, 2002.

¹¹⁰ See, e.g., letter from New York County Lawyers’ Association dated December 3, 2002.

¹¹¹ See, e.g., *In the Matter of Donald F. Marcus and In the Matter of Harry P. Adler*, AAER 1715 (February 10, 2003); *SEC v. John F. Mortell, et al.*, AAER 1569 (June 5, 2002); *In the Matter of Ronald G. Davies*, AAER 1281 (June 29, 2000); and *In the*