

Because the new rule is consistent with previous law, rules, and cases¹¹² we do not anticipate that the new rules will increase significantly costs for issuers or accounting firms.

Nonetheless, the Act and new rules might prompt some issuers to adopt procedures or guidelines that would assure additional care is used by an issuer's officers and directors, and others acting under their direction, in communicating with auditors of the issuer's financial statements. For example, some issuers might require that more discussions include members of senior management or the issuer's legal counsel. Because no particular procedures related to such communications are required, and the nature and scope of those procedures are likely to vary among issuers, it is difficult to provide an accurate cost estimate.

As noted above, in some circumstances the new rules might apply before the professional engagement period begins. For example, the rules would apply if an officer, director, or person acting under the direction of an officer or director, offers to engage an accounting firm on the condition that the firm either issue an unqualified audit report on financial statements that do not conform with generally accepted accounting principles, or limit the scope or performance of audit or review procedures in violation of generally accepted auditing standards. We believe, however, that such conduct would not be permitted under existing laws and regulations and, accordingly, the rules should not result in a significant increase in costs for issuers.

Potential benefits of the rules include increased investor confidence in the integrity of the audit process and, in turn, in the reliability of reported financial information. One of the most important factors in the successful operation of our securities markets is the trust that investors have in the reliability of the information used to make voting and investment decisions.¹¹³

Matter of Terry R. Kuntz and Richard J. Scheer, AAER 720 (September 26, 1995).

¹¹² *Id.*

¹¹³ See Accounting Series Release No. 296 (Aug. 20, 1981), which states in part:

(T)he capital formation process depends in large part on the confidence of investors in financial reporting. An investor's willingness to commit his capital to an impersonal market is dependent on the availability of accurate, material and timely information regarding the corporations in which he has invested or proposes to invest. The quality of information disseminated in the securities markets and the continuing conviction of individual investors that such information is reliable are thus

Section 303(a) and the new rules are designed to provide added assurance that the full-disclosure purposes of the securities laws are fulfilled,¹¹⁴ and to help restore the faith of America's investors in the integrity of the audit process and in the reliability of reported financial information. If section 303 of the Act and the new rules lead to increased investor confidence in financial reporting, they also might facilitate capital formation. An increased willingness of investors to participate in the securities markets could result in issuers being able to lower their cost of capital.

Commenters generally agreed that the costs associated with the new rules are not significant.¹¹⁵ One commenter, however, indicated that increased costs might be associated with more litigation and increased liability exposure for accounting firms.¹¹⁶ Because there is no private right action under section 303 or the new rule,¹¹⁷ we expect that such costs will not be significant.

V. Final Regulatory Flexibility Analysis

This Final Regulatory Flexibility Act Analysis has been prepared in accordance with 5 U.S.C. 604. It relates to revised rule 13b2-2 of Regulation

key to the formation and effective allocation of capital. Accordingly, the audit function must be meaningfully performed and the accountant's independence not compromised.

¹¹⁴ See, e.g., H.R. Rep. No. 1383, 73rd Cong., 2d Sess., 11 (1934), which states:

Just as artificial manipulation tends to upset the true function of an open market, so the hiding and secreting of important information obstructs the operation of the markets as indices of real value. There cannot be honest markets without honest publicity.

Manipulation and dishonest practices of the market place thrive upon mystery and secrecy.

This House Report also includes a letter from the Executive Assistant of the Committee on Stock List for the New York Stock Exchange, which recognizes management's need for accurate financial information and then states:

[U]nder the conditions of today, the next object in order of importance has become to give stockholders, in understandable form, such information in regard to the business as will avoid misleading them in any respect and as will put them in possession of all information needed, and which can be supplied in financial statements, to determine the true value of their investments * * *. The exchange is interested in the accounts of companies as a source of reliable information for those who deal in stocks. It is not sufficient for the stock exchange that the accounts should be in conformity with law or even that they should be conservative; the stock exchange desires that they should be fully and fairly informative.

Id. at 12.

¹¹⁵ See, e.g., letters from National Association of State Boards of Accountancy dated November 25, 2002 and PwC dated November 25, 2002.

¹¹⁶ Letter from Independent Community Bankers of America dated November 25, 2002.

¹¹⁷ Section 303(b) of the Act states, "In any civil proceeding, the Commission shall have exclusive authority to enforce this section and any rule or regulation under this section."

13B-2, which implements the statutory prohibition on officers and directors of an issuer, and persons acting under their direction, improperly influencing the conduct of an audit or review of the issuer's financial statements.

A. Reasons for, and Objectives of, the Rules

The purpose of the new rules is to implement section 303(a) of the Act. The rules prohibit officers and directors of issuers, including "small businesses," and persons acting under their direction, from improperly influencing an accounting firm's audit or review of the issuer's financial statements. Regardless of the application of section 303(a) and the new rules, such conduct would violate the anti-fraud or other provisions of the securities laws or aid and abet or cause the issuer's violations of those sections. The new rules, and section 303(a) of the Act, provide the Commission with an additional means to address such conduct and are intended to enhance the credibility of financial statements.

B. Significant Issues Raised by Public Comments

Some commenters indicated that the cost of compliance with the rules is not significant and that there should be no differences in the rules for small companies.¹¹⁸ Another commenter stated that special rules are not necessary for small entities if the definitions of officer and director are sufficiently broad to include persons who normally have the responsibility for governance of an entity.¹¹⁹ As noted above, under the securities laws and the Commission's regulations, the definition of "officer" includes not only those with certain corporate titles but also those performing corresponding functions with respect to any organization,¹²⁰ and the definition of "director" includes not only directors of corporations but also those performing similar functions with respect to any organization.¹²¹ Such definitions are sufficiently broad to include persons responsible for governance of an entity.

One comment letter, responding to the Commission's rule proposals related to sections 404, 406 and 407 of the Act, as well as section 303, encouraged the Commission to exempt small companies

¹¹⁸ See, e.g., letters from PwC dated November 25, 2002 and Robert Waxman dated November 25, 2002.

¹¹⁹ Letter from National Association of State Boards of Accountancy dated November 25, 2002.

¹²⁰ See Rules 3b-2 and 3b-7 under the Exchange Act, 17 CFR 240.3b-2 and 240.3b-7.

¹²¹ See section 3(a)(7) of the Exchange Act, 15 U.S.C. 78c(a)(7).