

from the “onerous and sometimes impossible rules for board membership.”¹²² These comments, however, would appear to address the requirements related to the disclosure of an “audit committee financial expert” under section 407 and not improperly influencing auditors under section 303. This commenter also suggested that we “nurture and encourage business formation and finance” and not impose “insurmountable difficulties for the smaller companies.”¹²³ We believe that enhanced investor confidence in the audit process will encourage capital formation by all companies and that the new rule, which addresses conduct that generally was unlawful prior to the enactment of the Act, does not place “insurmountable difficulties” on small companies.

Another commenter stated that the Commission should be mindful of difficulties some smaller institutions face “in seeking auditing firm alternatives and complying with other new regulatory requirements due to limited staff resources.”¹²⁴ Although the rule might encourage some companies to exercise additional care in communicating with auditors, the rule does not impose any specific requirements on companies and should not result in the use of additional staff resources. Accordingly, we do not believe that it imposes significant costs on small entities.

C. Small Entities Subject to the Rules

The rules affect small registrants that are small entities. Exchange Act Rule 0–10(a)¹²⁵ and 1933 Act Rule 157¹²⁶ define a company to be a “small business” or “small organization” if it had total assets of \$5 million or less on the last day of its most recent fiscal year. We estimate that approximately 2,500 companies are small entities, other than investment companies.

For purposes of the Regulatory Flexibility Act, an investment company is a small entity if it, together with other investment companies in the same group of related investment companies, has net assets of \$50 million or less as of the end of its most recent fiscal year.¹²⁷ We estimate that approximately 225 investment companies meet this definition.

D. Reporting, Recordkeeping and Other Compliance Requirements

The enactment of section 303(a) of the Act and the adoption of the rules might result in some issuers adopting more detailed procedures for communications between the company and the accounting firm that audits the company’s financial statements. These procedures might result in an insignificant increase in costs associated with compliance with the securities laws.

We received no comments or data indicating the extent of burden that might be imposed on small entities. As noted above, we assume the burden would be minor for most issuers.

E. Agency Action To Minimize Effects on Small Entities

The Regulatory Flexibility Act directs us to consider significant alternatives that would accomplish the stated objective, while minimizing any significant adverse impact on small entities. In connection with the amendments, we considered the following alternatives:

1. The establishment of differing compliance or reporting requirements or timetables that take into account the resources of small entities;
2. The clarification, consolidation, or simplification of compliance and reporting requirements under the rules for small entities;
3. The use of performance rather than design standards; and
4. An exemption from coverage of the amendments, or any part thereof, for small entities.

Section 303(a) of the Act does not provide an exemption for small businesses. The section does provide, however, that the rules adopted by the Commission should be “as necessary and appropriate in the public interest and for the protection of investors.”

We considered not applying the rules to small business issuers. We believe, however, that investors in small companies, just as investors in large companies, would want and benefit from the added confidence in reported financial information that comes from knowing that efforts to improperly influence the performance of the audit have been prohibited.

We are using a performance standard rather than a design standard. In addition, Congress has dictated the timetable for this rulemaking.

VI. Consideration of Impact on the Economy, Burden on Competition, and Promotion of Efficiency, Competition and Capital Formation

Section 23(a)(2) of the Exchange Act¹²⁸ requires us, when adopting rules under the Exchange Act, to consider the impact on competition of any rule we adopt. Section 2(b) of the 1933 Act,¹²⁹ section 3(f) of the Exchange Act,¹³⁰ and section 2(c) of the Investment Company Act of 1940,¹³¹ require us, when engaging in rulemaking where we are required to consider or determine whether the action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition and capital formation.

The new rules prohibit improper influences on auditors in connection with their reviews and audits of financial statements filed with the Commission. The proposals, therefore, should enhance investor confidence in the audit process and in the quality of information available to them, and lead to a more efficient market.

Because of the nature of the new rules, we do not believe that they would impose any burden on competition. They prohibit equally all officers and directors of public companies (and persons acting under their direction) from improperly influencing the auditor.

As noted in the cost-benefit section, if section 303 of the Act and the new rules lead to increased investor confidence in financial reporting, they also may facilitate capital formation. An increased willingness of investors to participate in the securities markets might result in issuers being able to lower their cost of capital.

We received no comments indicating that the rule would impact competition, efficiency or capital formation.

VII. Statutory Authority

We are adopting the new rules under the authority set forth in sections 3(a) and 303 of the Act; Schedule A and sections 5, 6, 7, 8, 10 and 19 of the 1933 Act; Sections 3, 10A, 12, 13, 14, 15, 17 and 23 of the Exchange Act; and Sections 6, 8, 20, 30, 31 and 38 of the Investment Company Act of 1940.

Text of Rules and Amendments

List of Subjects in 17 CFR Part 240 Securities.

¹²² Letter from Nicholas Taylor dated November 8, 2002.

¹²³ *Id.*

¹²⁴ Letter from Independent Community Bankers of America dated November 25, 2002.

¹²⁵ 17 CFR 240.0–10(a).

¹²⁶ 17 CFR 230.157

¹²⁷ 17 CFR 270.0–10.

¹²⁸ 15 U.S.C. 78w(a)(2).

¹²⁹ 15 U.S.C. 77b(b).

¹³⁰ 15 U.S.C. 78c(f).

¹³¹ 15 U.S.C. 80a–2(c).