

topic and related comments in more detail throughout the release. We believe that the new rules and amendments are in the public interest and consistent with the protection of investors.

The Proposing Release also included requirements to implement Section 404 of the Act, relating to internal control reports and auditor attestations of those reports. We will set forth the final rules to implement Section 404 in a separate adopting release to be issued at a later date. The Sarbanes-Oxley Act does not mandate that we issue final rules to implement Section 404 by a specific date. In addition, in the Proposing Release, we proposed to defer effectiveness of those rules so that they would apply only to companies whose fiscal years end on or after September 15, 2003 to allow the Public Company Accounting Oversight Board sufficient time to adopt standards for attestation engagements, and to allow companies and auditors sufficient time to prepare for imposition of the new requirements.

We also will set forth the rules to implement the requirements of Sections 406 and 407 of the Sarbanes-Oxley Act with respect to registered investment companies in a subsequent release. We expect to consider implementing these requirements at the same time that we consider adopting proposed Form N-CSR¹³ to be used by registered management investment companies to file certified shareholder reports with the Commission under Section 302 of the Sarbanes-Oxley Act.

II. Discussion

A. Audit Committee Financial Experts

1. Title of the Expert

In the Proposing Release, we solicited comment as to whether we should use the term “financial expert” in our rules consistent with its use in Section 407 of the Sarbanes-Oxley Act, or whether a different term such as “audit committee financial expert” would be more appropriate. A number of commenters expressed a concern that neither the term “financial expert” nor “audit committee financial expert” accurately reflects the required experience and expertise of the type of expert contemplated by Section 407 and our proposed rules. Some noted that many of the key characteristics included in our proposed definition of a financial expert relate to the expert’s accounting knowledge and experience in an accounting or auditing position. One commenter therefore recommended that

we use the term “audit committee accounting expert.” Other suggested terms included “accounting expert,” “audit committee member financial lead” and “financially proficient director.”

We agree that the term “financial” may not completely capture the attributes referenced in Section 407, given the provision’s focus on accounting and auditing expertise and the fact that traditional “financial” matters extend to capital structure, valuation, cash flows, risk analysis and capital-raising techniques. Furthermore, several recent articles on the proposals have noted that many experienced investors and business leaders with considerable financial expertise would not necessarily qualify as financial experts under the proposed definition.¹⁴ We have decided to use the term “audit committee financial expert” in our rules implementing Section 407 instead of the term “financial expert.”¹⁵ This term suggests more pointedly that the designated person has characteristics that are particularly relevant to the functions of the audit committee, such as: a thorough understanding of the audit committee’s oversight role, expertise in accounting matters as well as understanding of financial statements, and the ability to ask the right questions to determine whether the company’s financial statements are complete and accurate. The new rules include a definition of the term “audit committee financial expert.”¹⁶

2. Disclosure of the Number and Names of Audit Committee Financial Experts

A substantial number of commenters opposed our proposal to require a company to disclose the number and names of the persons that the company’s board determined to be audit committee financial experts. Some were opposed on the ground that our proposed rules exceeded the mandates of the Sarbanes-Oxley Act.¹⁷ Much of the opposition

stemmed from a fear that the designation of an audit committee financial expert may inappropriately suggest that the expert bears greater responsibility, and therefore is subject to a higher degree of liability, for audit committee decisions than other audit committee members. Some commenters thought that identification of the audit committee financial expert in the company’s annual report would exacerbate that problem and discourage qualified persons from serving as such experts.

We have modified the proposals that would have required disclosure of the number and names of audit committee financial experts serving on a company’s audit committee to more closely track the language used in Section 407 of the Sarbanes-Oxley Act. Under the rules that we are adopting, a company must disclose that its board of directors has determined that the company either:

- Has at least one audit committee financial expert serving on its audit committee; or
- Does not have an audit committee financial expert serving on its audit committee.

A company disclosing that it does not have an audit committee financial expert must explain why it does not have such an expert. We continue to believe that disclosure of the name of the audit committee financial expert is necessary to benefit investors and to carry out the purpose of Section 407. Therefore, under the final rules, if a company discloses that it has an audit committee financial expert, it also must disclose the expert’s name. We believe that, in general, omission of the expert’s name ultimately would not result in the expert’s identity remaining non-public. To the extent that there are liability concerns, we believe that they are best addressed by our inclusion of a safe harbor in our rules, as discussed below.

The final rules permit, but do not require, a company to disclose that it has more than one audit committee financial expert on its audit committee. Therefore, once a company’s board determines that a particular audit committee member qualifies as an audit committee financial expert, it may, but is not required to, determine whether additional audit committee members also qualify as experts. Every company subject to the audit committee disclosure requirements would, however, have to determine whether or not it has at least one audit committee financial expert; a company will not

company had at least one financial expert on its audit committee, and if not, the reasons why.

¹³ See Release No. IC-25723 (Aug. 30, 2002) [67 FR 57298].

¹⁴ See Andrew R. Sorkin, “Back to School, but This One Is for Top Corporate Officials,” NY Times, Sept. 3, 2002, Cassell Bryan-Low, “Defining Moment for SEC: Who is a financial expert,” Wall Street Journal, Dec. 9, 2002, and Geoffrey Colvin, “Sarbanes & Co. Can’t Want This: Under Reform Law, Alan Greenspan Would Not Qualify as a Board’s Financial Expert,” Fortune, Dec. 30, 2002.

¹⁵ Throughout this release, we will refer to both “audit committee financial experts” and “financial experts” as appropriate in a particular context. For example, when discussing statutory provisions, we will continue to refer to financial experts. For purposes of the discussions in this release, the meanings of these terms are identical.

¹⁶ See new Item 401(h)(2) of Regulation S-K, Item 401(e)(2) of Regulation S-B, Item 16A(b) of Form 20-F, and paragraph (8)(b) of General Instruction B to Form 40-F.

¹⁷ The Sarbanes-Oxley Act required only that we adopt rules requiring disclosure of whether a