

satisfy the new disclosure requirements by stating that it has decided not to make a determination or by simply disclosing the qualifications of all of its audit committee members. Furthermore, if the company's board determines that at least one of the audit committee members qualifies as an expert, the company must accurately disclose this fact. It will not be appropriate for a company to disclose that it does not have an audit committee financial expert if its board has determined that such an expert serves on the audit committee.

### 3. Disclosure of Independence of Audit Committee Financial Experts

We proposed to require a company to disclose whether its audit committee financial expert is independent of management. A number of commenters opposed this disclosure requirement as unnecessary, noting that Section 301 of the Sarbanes-Oxley Act mandates the Commission to direct the self-regulatory organizations to prohibit the listing of any company that does not require all of its audit committee members to be independent. However, not all Exchange Act reporting companies are listed on a national securities exchange or association.<sup>18</sup> We believe that investors in these companies would be interested in knowing whether the audit committee financial expert is independent of management. Therefore, the final rules require a company to disclose whether the person or persons identified as the audit committee financial expert is independent of management.

In the proposing release, we defined "independent" by reference to Section 10A(m)(3) of the Exchange Act.<sup>19</sup> Several commenters noted that this reference may cause some confusion because the securities laws include different definitions of the term "affiliated," which is part of the definition used in Section 10A(m)(3).<sup>20</sup> Therefore, to provide clarity, the final rules refer to the definition of "independent" used in Item 7(d)(3)(iv)

of Schedule 14A.<sup>21</sup> This revision ensures that the term "independent" is used consistently in our rules.<sup>22</sup>

### 4. Definition of "Audit Committee Financial Expert"

*a. Proposed definition of the term "financial expert".* We proposed to define the term "financial expert" to mean a person who has, through education and experience as a public accountant, auditor, principal financial officer, controller or principal accounting officer, of a company that, at the time the person held such position, was required to file reports pursuant to Section 13(a) or 15(d) of the Exchange Act, or experience in one or more positions that involve the performance of similar functions (or that results, in the judgment of the company's board of directors, in the person's having similar expertise and experience),<sup>23</sup> the following attributes:

(1) An understanding of generally accepted accounting principles and financial statements;

(2) Experience applying such generally accepted accounting principles in connection with the accounting for estimates, accruals, and reserves that are generally comparable to the estimates, accruals and reserves, if any, used in the registrant's financial statements;

(3) Experience preparing or auditing financial statements that present accounting issues that are generally

<sup>21</sup> 17 CFR 240.101. That item currently relies on the definitions of "independent" in the listing standards of the New York Stock Exchange, the American Stock Exchange and the NASD. Under Section 10A(m) of the Exchange Act (as amended by Section 301 of the Sarbanes-Oxley Act), we recently proposed rules directing the national securities exchanges and national securities associations to prohibit the listing of any security of an issuer that, among other things, does not have an independent audit committee as that term is used in Section 10A(m)(3). See Release No. 33-8173 (Jan. 8, 2003). As a result of those proposals, the current references in Item 7(d)(3)(iv) of Schedule 14A may be amended. See *id.*

<sup>22</sup> For domestic issuers, the audit committee independence standard is found in new Regulation S-K Item 401(h)(1)(ii) (17 CFR 229.401(h)(1)(ii)) and Regulation S-B Item 401(e)(1)(ii) (17 CFR 228.401(e)(1)(ii)). See Part ILC, below for further discussion of the audit committee financial expert disclosure requirements for foreign issuers.

<sup>23</sup> The proposed definition would have broadened the types of persons listed in Section 407 of the Sarbanes-Oxley Act as qualified to serve as experts by enabling the board of directors to conclude that a person is a financial expert if, in lieu of having experience as a public accountant, auditor, principal financial officer, principal accounting officer, or controller, or experience in a position involving the performance of similar functions, the person has experience in a position that results, in the judgment of the board of directors, in the person having similar expertise and experience. Under the proposals, if the board made such a determination, the company would have been required to disclose the basis for that determination.

comparable to those raised by the registrant's financial statements;

(4) Experience with internal controls and procedures for financial reporting; and

(5) An understanding of audit committee functions.

In addition, the proposed rule would have provided guidance to companies by providing a list of factors to be considered in making that evaluation, including:

- The level of the person's accounting or financial education, including whether the person has earned an advanced degree in finance or accounting;

- Whether the person is a certified public accountant, or the equivalent, in good standing, and the length of time that the person actively has practiced as a certified public accountant, or the equivalent;

- Whether the person is certified or otherwise identified as having accounting or financial experience by a recognized private body that establishes and administers standards in respect of such expertise, whether that person is in good standing with the recognized private body, and the length of time that the person has been actively certified or identified as having this expertise;

- Whether the person has served as a principal financial officer, controller or principal accounting officer of a company that, at the time the person held such position, was required to file reports pursuant to Section 13(a) or 15(d) of the Exchange Act, and if so, for how long;

- The person's specific duties while serving as a public accountant, auditor, principal financial officer, controller, principal accounting officer or position involving the performance of similar functions;

- The person's level of familiarity and experience with all applicable laws and regulations regarding the preparation of financial statements that must be included in reports filed under Section 13(a) or 15(d) of the Exchange Act;

- The level and amount of the person's direct experience reviewing, preparing, auditing or analyzing financial statements that must be included in reports filed under Section 13(a) or 15(d) of the Exchange Act;

- The person's past or current membership on one or more audit committees of companies that, at the time the person held such membership, were required to file reports pursuant to Section 13(a) or 15(d) of the Exchange Act;

- The person's level of familiarity and experience with the use and analysis of

<sup>18</sup> As we note in our recent release proposing rules to implement Section 301 of the Sarbanes-Oxley Act, there are only 7,250 listed companies out of a total of approximately 17,000 reporting companies. See Release No. 33-8173 (Jan. 8, 2003).

<sup>19</sup> 15 U.S.C. 78j-1(m)(3).

<sup>20</sup> For example, Section 2(a)(3) of the Investment Company Act of 1940 (15 U.S.C. 80a-2(a)(3)) defines an "affiliated person" as, among other things, any person owning with power to vote five percent of the outstanding voting securities of an entity. Rule 405 (17 CFR 230.405) under the Securities Act defines an "affiliate" as a person that controls or is controlled by, or is under common control with a specified person.