

(3) Experience overseeing or assessing the performance of companies or public accountants with respect to the preparation, auditing or evaluation of financial statements; or

(4) Other relevant experience.²⁶

d. Discussion of Significant

Modifications to the Proposed Definition of "Financial Expert". We have made several changes to our proposed definition of a financial expert. As already discussed, we have decided to use the term audit committee financial expert rather than financial expert in the final rules. We also have reorganized the components of the definition to make it easier to read and to emphasize, by including them in the first part of the definition, the attributes that an audit committee financial expert must possess. The second part of the definition discusses the means by which a person must acquire the necessary attributes. We also have eliminated the proposed instruction listing several factors that a company's board of directors should consider in evaluating the education and experience of an audit committee financial expert candidate.

Proposed attributes of a financial expert. i. The financial expert must have an understanding of generally accepted accounting principles and financial statements. We are adopting this attribute substantially as proposed. However, in response to comments, we have added an instruction to clarify that, with respect to foreign private issuers, the audit committee financial expert's understanding must be of the generally accepted accounting principles used by the foreign private issuer in preparing its primary financial statements filed with the Commission.²⁷ Our rules require foreign private issuers that do not prepare their primary financial statements in accordance with U.S. generally accepted accounting principles to include a reconciliation to those principles in the financial statements that they file with the Commission. Although an understanding of reconciliation to U.S. generally accepted accounting principles would be helpful, we believe that the proper focus of audit committee financial expertise is on the principles used to prepare the primary financial statement. We also are sensitive to the

fact that requiring an audit committee financial expert to possess expertise relating to U.S. generally accepted accounting principles could burden foreign private issuers who use home country accounting principles or international accounting standards to prepare their primary financial statements.

ii. The financial expert must have 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. Several commenters were concerned that potential audit committee financial experts would not have experience with the unique and complex accounting for estimates, accruals and reserves in certain industries, such as the insurance industry, unless they have had direct previous experience in these industries. The commenters further noted that there could be a very limited pool of audit committee financial expert candidates available with such experience that would not have ties to a competitor within the same industry. In light of these comments, we have revised this attribute by eliminating the clause "that are generally comparable to the estimates, accruals and reserves, if any, used in the registrant's financial statements." We also have revised this attribute to state that the audit committee financial expert must have the ability to assess the general application of generally accepted accounting principles in connection with the accounting for estimates, accruals and reserves, rather than stating that the expert must have experience applying these principles.²⁸ We believe that this description of the attribute better satisfies the intent of the statute and better reflects the role to be played by audit committees. We recognize that the pool of persons possessing the highly specialized technical knowledge that some thought the proposals necessitated may be so small that a substantial percentage of companies in certain industries would be compelled to disclose that they could not retain an expert without recruiting a person associated with a competitor. We do not intend for the new requirements to lead to such a result. An audit committee financial expert must be able to assess the general application of generally accepted accounting

principles in connection with accounting for estimates, accruals and reserves. This general attribute provides the necessary background for an audit committee when addressing more detailed industry-specific standards or other particular topics. Experience with such detailed standards or topics is not a necessary attribute of audit committee financial expertise.

iii. The financial expert must have experience preparing or auditing financial statements that present accounting issues that are generally comparable to those raised by the registrant's financial statements. The majority of commenters who thought that the proposed definition of "financial expert" was too restrictive focused on this attribute. We are convinced by the weight of the comments that the proposed requirement that an expert have direct experience preparing or auditing financial statements could impose an undue burden on some companies, especially small companies, that desire to have an audit committee financial expert. We also are persuaded by commenters' arguments that persons who have experience performing in-depth analysis and evaluation of financial statements should not be precluded from being able to qualify as audit committee financial experts if they possess the other four necessary attributes of an expert. We therefore have broadened this attribute by requiring an audit committee financial expert to have experience "preparing, auditing, analyzing or evaluating" financial statements.²⁹

We believe that our revisions properly capture the clear intent of the statute that an audit committee financial expert must have experience actually working directly and closely with financial statements in a way that provides familiarity with the contents of financial statements and the processes behind them. We also believe that our revisions appropriately broaden the group of persons who are eligible to be audit committee financial experts. We recognize that many people actively engaged in industries such as investment banking and venture capital investment have had significant direct and close exposure to, and experience with, financial statements and related processes. Similarly, professional financial analysts closely scrutinize financial statements on a regular basis. Indeed, all of these types of individuals

²⁶ See new Item 401(h)(3) of Regulation S-K, Item 401(e)(3) of Regulation S-B, Item 16A(c) of Form 20-F and paragraph (8)(c) of General Instruction B to Form 40-F.

²⁷ See new Instruction 3 to Item 401(h) of Regulation S-K, Item 401(e) of Regulation S-B, Instruction 3 to Item 16A of Form 20-F, and Note 3 to paragraph (8) of General Instruction B to Form 40-F.

²⁸ See new Item 401(h)(2)(ii) of Regulation S-K, Item 401(e)(2)(ii) of Regulation S-B, Item 16A(b)(2) of Form 20-F and paragraph (8)(b)(2) of General Instruction B to Form 40-F.

²⁹ See new Item 401(h)(2)(iii) of Regulation S-K, Item 401(e)(2)(iii) of Regulation S-B, Item 16A(b)(3) of Form 20-F and paragraph (8)(b)(3) of General Instruction B to Form 40-F.