

often hold positions that require them to inspect financial statements with a healthy dose of skepticism. They therefore would be well prepared to diligently and zealously question management and the company's auditor about the company's financial statements. Effective audit committee members must have both the ability and the determination to ask the right questions. Therefore, we have broadened this attribute to include persons with experience performing extensive financial statement analysis or evaluation.

We also are convinced by commenters that a potential audit committee financial expert should be considered to possess this attribute by virtue of his or her experience actively supervising a person who prepares, audits, analyzes or evaluates financial statements. The term "active supervision" means more than the mere existence of a traditional hierarchical reporting relationship between supervisor and those being supervised. Rather, we mean that a person engaged in active supervision participates in, and contributes to, the process of addressing, albeit at a supervisory level, the same general types of issues regarding preparation, auditing, analysis or evaluation of financial statements as those addressed by the person or persons being supervised. We also mean that the supervisor should have experience that has contributed to the general expertise necessary to prepare, audit, analyze or evaluate financial statements that is at least comparable to the general expertise of those being supervised. A principle executive officer should not be presumed to qualify. A principal executive officer with considerable operations involvement, but little financial or accounting involvement, likely would not be exercising the necessary active supervision. Active participation in, and contribution to, the process, albeit at a supervisory level, of addressing financial and accounting issues that demonstrates a general expertise in the area would be necessary.

Finally, we are retaining, with clarification, the requirement that an audit committee financial expert have experience with financial statements that present accounting issues that are "generally comparable" to those raised by the registrant's financial statements. We do not intend for this phrase to imply that a person must have previous experience in the same industry as the company that is evaluating the person as a potential audit committee financial expert, or that the person's experience must have been with a company subject

to the Exchange Act reporting requirements. We therefore have modified the requirement to focus on the breadth and level of complexity of the accounting issues with which the person has had experience. We think that a company's board of directors will make the necessary assessment based on particular facts and circumstances. In making its assessment, the board should focus on a variety of factors such as the size of the company with which the person has experience, the scope of that company's operations and the complexity of its financial statements and accounting. We do not believe that familiarity with particular financial reporting or accounting issues, or any other narrow area of experience should be dispositive.

*iv. A financial expert must have experience with internal controls and procedures for financial reporting.* We are substituting the term "understanding" for the term "experience."<sup>30</sup> In our view, it is necessary that the audit committee financial expert understand the purpose, and be able to evaluate the effectiveness, of a company's internal controls and procedures for financial reporting. It is important that the audit committee financial expert understand why the internal controls and procedures for financial reporting exist, how they were developed, and how they operate. Previous experience establishing or evaluating a company's internal controls and procedures for financial reporting can, of course, contribute to a person's understanding of these matters, but the attribute as rephrased properly focuses on the understanding rather than the experience.

*v. A financial expert must have an understanding of audit committee functions.* We are adopting this attribute as proposed.<sup>31</sup>

*Means of obtaining expertise.* We have revised the audit committee financial expert definition to state that a person must have acquired the five necessary attributes through any one or more of the following:

(1) Education and experience as a principal financial officer, principal accounting officer, controller, public accountant or auditor or experience in one or more positions that involve the performance of similar functions;

(2) Experience actively supervising a principal financial officer, principal accounting officer, controller, public accountant, auditor or person performing similar functions;

(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.<sup>32</sup>

In response to commenters' remarks, we have eliminated the proposed requirement that an audit committee financial expert must have gained the relevant experience with 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. Many private companies are contractually required to prepare audited financial statements that comply with generally accepted accounting principles. In addition, a potential expert may have gained relevant experience at a foreign company that is publicly traded in its home market but that is not registered under the Exchange Act.

We have added a provision in response to comments that experience overseeing or assessing the performance of companies or public accountants with respect to the preparation, auditing or evaluation of financial statements can provide a person with in-depth knowledge and experience of accounting and financial issues. For example, certain individuals serving in governmental, self-regulatory and private-sector bodies overseeing the banking, insurance and securities industries work on issues related to financial statements on a regular basis. We believe that such experience can constitute a very useful background for an audit committee financial expert.

In addition, we have revised the last provision of this part of the proposed definition. The original proposal stated that a person who had not served in one of the specified positions alternatively could have acquired the relevant attributes and experience in a position that results, in the judgment of the board of directors, in the person's having similar expertise and experience. The final rules state simply that a person may acquire the necessary attributes of an audit committee financial expert through other relevant experience, and no longer require the company to disclose the basis for the board's determination that a person has

<sup>30</sup> See new Item 401(h)(2)(iv) of Regulation S-K, Item 401(e)(2)(iv) on Regulation S-B, Item 16A(b)(4) of Form 20-F and paragraph (8)(b)(4) of General Instruction B to Form 40-F.

<sup>31</sup> See new Item 401(h)(2)(v) of Regulation S-K, Item 401(e)(2)(v) on Regulation S-B, Item 16A(b)(5) of Form 20-F and paragraph (8)(b)(5) of General Instruction B to Form 40-F.

<sup>32</sup> See new Item 401(h)(3) of Regulation S-K, Item 401(e)(3) on Regulation S-B, Item 16A(c) of Form 20-F and paragraph (8)(c) of General Instruction B to Form 40-F.