

for purposes of Section 11 of the Securities Act,³⁵ as a result of being designated or identified as an audit committee financial expert pursuant to the new disclosure item;

- The designation or identification of a person as an audit committee financial expert pursuant to the new disclosure item does not impose on such person any duties, obligations or liability that are greater than the duties, obligations and liability imposed on such person as a member of the audit committee and board of directors in the absence of such designation or identification; and

- The designation or identification of a person as an audit committee financial expert pursuant to the new disclosure item does not affect the duties, obligations or liability of any other member of the audit committee or board of directors.³⁶

This safe harbor clarifies that any information in a registration statement reviewed by the audit committee financial expert is not “expertised” unless such person is acting in the capacity of some other type of traditionally recognized expert. Similarly, because the audit committee financial expert is not an expert for purposes of Section 11,³⁷ he or she is not subject to a higher level of due diligence with respect to any portion of the registration statement as a result of his or her designation or identification as an audit committee financial expert.

In adopting this safe harbor, we wish to emphasize that all directors bear significant responsibility. State law generally imposes a fiduciary duty upon directors to protect the interests of a company’s shareholders. This duty requires a director to inform himself or herself of relevant facts and to use a “critical eye” in assessing information

prior to acting on a matter.³⁸ Our new rule provides that whether a person is, or is not, an audit committee financial expert does not alter his or her duties, obligations or liabilities. We believe this should be the case under federal and state law.

6. Determination of a Person’s Status as an Audit Committee Financial Expert

The Sarbanes-Oxley Act does not explicitly state who at the company should determine whether a person qualifies as an audit committee financial expert. We believe that the board of directors in its entirety, as the most broad-based body within the company, is best-equipped to make the determination. We think that it is appropriate that any such determination will be subject to relevant state law principles such as the business judgment rule.

7. Location of Audit Committee Financial Expert Disclosure

The Sarbanes-Oxley Act expressly states that companies must include the financial expert disclosure in their periodic reports required pursuant to Section 13(a) or 15(d) of the Exchange Act. The final rules that we are adopting require companies to include the new disclosure in their annual reports on Forms 10-K, 10-KSB, 20-F or 40-F. The requirement to provide the new audit committee disclosure item is included in Part III of Forms 10-K and 10-KSB, enabling a domestic company that voluntarily chooses to include this disclosure in its proxy or information statement to incorporate this information by reference into its Form 10-K or 10-KSB if it files the proxy or information statement with the Commission no later than 120 days after the end of the fiscal year covered by the Form 10-K or 10-KSB.³⁹

Although some commenters recommended that we require companies to include the audit committee financial expert disclosure in their proxy and information statements, registration statements and quarterly reports, as well as in their annual reports, we are not convinced that the benefits to investors would exceed the costs to companies of requiring this disclosure in additional documents or on a more frequent basis.

8. Change in Item Number

We proposed to designate the audit committee financial expert disclosure

requirement as new Item 309 of Regulations S-K and S-B.⁴⁰ However, existing Item 401 seems to be a more logical location for this requirement. Item 401 currently requires, among other things, a brief description of the business experience of each director. Therefore, we are designating the new disclosure item as Item 401(h) of Regulation S-K and Item 401(e) of Regulation S-B. The new item specifies that a company may choose to include the audit committee financial expert disclosure in its proxy or information statement if the company incorporates such information into its annual report as permitted by the instructions to Forms 10-K and 10-KSB.⁴¹

B. Code of Ethics

1. Code of Ethics Disclosure Requirements

a. Proposed Disclosure Requirements. Section 406 of the Sarbanes-Oxley Act directs us to issue rules requiring a company that is subject to the reporting requirements of Section 13(a) or 15(d) of the Exchange Act to disclose whether or not the company has adopted a code of ethics for its senior financial officers that applies to the company’s principal financial officer and controller or principal accounting officer, or persons performing similar functions. The Act further directs us to require companies that have not adopted such a code of ethics to explain why they have not done so. In addition to requiring the disclosure mandated by Section 406, we proposed rules to require disclosure as to whether the company has a code of ethics that applies to its principal executive officer.

b. Commenters’ Remarks. Some of the commenters thought that the required disclosure should be limited to a statement indicating whether the company has a code of ethics that applies to its senior financial officers, and if not, why not. Others stated that it was appropriate to expand the requirements of the Sarbanes-Oxley Act to also require a company to disclose whether it has a code of ethics that applies to its principal executive officer. A few commenters thought that we should extend the requirement even further to require a company to state whether it has a code of ethics that applies to other individuals, such as directors, all executive officers, and the company’s employees generally.

³⁵ 15 U.S.C. 77k.

³⁶ See new Item 401(h)(4) of Regulation S-K, Item 401(e)(4) of Regulation S-B, Item 16A(d) of Form 20-F and paragraph (8)(d) of General Instruction B to Form 40-F. Although other audit committee members may look to the audit committee financial expert as a resource on certain issues that arise, audit committee members should work together to perform the committee’s responsibilities. The safe harbor provides that other audit committee members may not abdicate their responsibilities.

³⁷ Section 11 of the Securities Act imposes liability for material misstatements and omissions in a registration statement, but provides a defense to liability for those who perform adequate due diligence. The level of due diligence required depends on the position held by a defendant and the type of information at issue. *Escott v. BarChris Construction Corp.*, 283 F. Supp. 643 (S.D.N.Y. 1968). The type of information can be categorized as either “expertised,” which means information that is prepared or certified by an expert who is named in the registration statement, or “non-expertised.” Similarly, a defendant can be characterized either as an “expert” or a “non-expert.”

³⁸ See, for example, *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985).

³⁹ See General Instruction E(3) to Form 10-KSB [17 CFR 249.310b] and General Instruction G(3) to Form 10-K [17 CFR 249.310].

⁴⁰ We had proposed to add new items to Forms 20-F and 40-F as well. Those item numbers have not changed.

⁴¹ See new Instruction 1 to Item 401(h) of Regulation S-K and Item 401(e) of Regulation S-B.