

rules, small business issuers need not make such disclosure until they file their annual reports for fiscal years ending December 15, 2003 or later. This deferral provides a small business issuer that does not currently have an audit committee member that would qualify as an audit committee financial expert under the new definition with more time to identify and recruit one. We note in this regard that our rules do not require any company to have an audit committee financial expert serving on its audit committee; they only require disclosure of whether such an expert serves on the company's audit committee.

As explained in this release, we also have significantly expanded the definition of the term "audit committee financial expert" for all companies. Several commenters noted that small businesses, in particular, would have difficulty attracting qualified persons. By expanding the definition, the rules increase the pool of available experts and ease the burden for all companies, including small entities, interested in recruiting qualified persons.

Also, we have revised our proposed requirement that all companies, including small entities, must file a copy of their code of ethics as an exhibit to their annual reports. As stated in the release, the adopted rules provide three different alternatives for a company to make its code of ethics publicly available. This revision allows companies to choose the least burdensome alternative.

We believe that the new disclosure requirements are clear and straightforward. The new rules require only brief disclosure. Therefore, it does not seem necessary to develop separate requirements for small entities. Similarly, we believe that applying a different definition of "audit committee financial expert" in a rule applicable only to small entities would not be appropriate. The final rules clarify that factors such as the complexity of a company's business and the accounting issues involved in a company's financial statements affect the level of experience and understanding that an audit committee financial expert should have. Because small entities tend to have less complex businesses and accounting issues than large companies, the definition provides significant flexibility to small entities. We have used design rather than performance standards in connection with the new disclosure items because we want this

disclosure to appear in a specific type of disclosure filing so that investors will know where to find the information. We do not believe that performance standards for small entities would be consistent with the purpose of the new rules.

VII. Statutory Basis

We are adopting amendments to Securities Exchange Act Form 10-K, Form 10-KSB, Form 20-F, Form 40-F, Form 8-K, Regulation S-B and Regulation S-K pursuant to Sections 5, 6, 7, 10, 17, 19 and 28 of the Securities Act, as amended, Sections 12, 13, 15, 23 and 36 of the Securities Exchange Act, as amended, and Sections 3(a), 406 and 407 of the Sarbanes-Oxley Act of 2002.

Text of the Proposed Amendments

List of Subjects

17 CFR Part 228

Reporting and recordkeeping requirements, Securities, Small businesses.

17 CFR Parts 229 and 249

Reporting and recordkeeping requirements, Securities.

For the reasons set out above, we amend title 17, chapter II of the Code of Federal Regulations as follows:

PART 228—INTEGRATED DISCLOSURE SYSTEM FOR SMALL BUSINESS ISSUERS

1. The authority citation for Part 228 is amended by adding the following citations in numerical order to read as follows:

Authority: 15 U.S.C. 77e, 77f, 77g, 77h, 77j, 77k, 77s, 77z-2, 77z-3, 77aa(25), 77aa(26), 77ddd, 77eee, 77ggg, 77hhh, 77jjj, 77nnn, 77sss, 78l, 78m, 78n, 78o, 78u-5, 78w, 78ll, 78mm, 80a-8, 80a-29, 80a-30, 80a-37 and 80b-11.

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Section 228.401 is also issued under secs. 3(a) and 407, Pub. L. 107-204, 116 Stat. 745.

Section 228.406 is also issued under secs. 3(a) and 406, Pub. L. 107-204, 116 Stat. 745.

Section 228.601 is also issued under secs. 3(a) and 406, Pub. L. 107-204, 116 Stat. 745.

2. Amend § 228.401 by adding paragraph (e) to read as follows:

§ 228.401 (Item 401) Directors, Executive Officers, Promoters and Control Persons.

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(e) *Audit committee financial expert.* (1)(i) Disclose that the small business issuer's board of directors has determined that the small business issuer either:

(A) Has at least one audit committee financial expert serving on its audit committee; or

(B) Does not have an audit committee financial expert serving on its audit committee.

(ii) If the small business issuer provides the disclosure required by paragraph (e)(1)(i)(A) of this Item, it must disclose the name of the audit committee financial expert and whether that person is *independent*, as that term is used in Item 7(d)(3)(iv) of Schedule 14A (240.14a-101 of this chapter) under the Exchange Act.

(iii) If the small business issuer provides the disclosure required by paragraph (e)(1)(i)(B) of this Item, it must explain why it does not have an audit committee financial expert.

Instruction to paragraph (e)(1) of Item 401. If the small business issuer's board of directors has determined that the small business issuer has more than one audit committee financial expert serving on its audit committee, the small business issuer may, but is not required to, disclose the names of those additional persons. A small business issuer choosing to identify such persons must indicate whether they are independent pursuant to Item 401(e)(1)(ii).

(2) For purposes of this Item, an *audit committee financial expert* means a person who has the following attributes:

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

(ii) The ability to assess the general application of such principles in connection with the accounting for estimates, accruals and reserves;

(iii) Experience preparing, auditing, analyzing or evaluating financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of issues that can reasonably be expected to be raised by the small business issuer's financial statements, or experience actively supervising one or more persons engaged in such activities;

(iv) An understanding of internal controls and procedures for financial reporting; and

(v) An understanding of audit committee functions.

(3) A person shall have acquired such attributes through:

(i) 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;

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

(iii) Experience overseeing or assessing the performance of companies

Flexibility Act as a company that, on the last day of its most recent fiscal year, had total assets of \$5 million or less.