



Analysis of New Audit Committee Regulations

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Executive Summary

Clients and Friends -

A process that began in September 1998 with the formation of the “Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees” (the BRC) is now complete. The BRC’s report and recommendations, issued in February 1999, were discussed in our publication *Shaping the Audit Committee Agenda* and our periodic *Audit Committee Updates*. The BRC called for formal rule changes by the New York Stock Exchange (NYSE), the National Association of Securities Dealers (NASD), the Securities and Exchange Commission (SEC), and the American Institute of Certified Public Accountants (AICPA). Over the last few months each of these bodies has exposed proposed rule changes for comment and in December, each finalized the rules which are described in this document and portions of which are presented in Appendix 1.

Many companies have highly effective audit committees, and their governance practices will not be impacted by these new rules aside from incremental disclosures. Other companies will be required to recruit new directors, establish new audit committee processes, and enhance communications with management and the auditors. Appendix 2 includes a proposal transition timeline for adopting these new rules.

The final rules are generally consistent with the original BRC recommendations with the following significant modifications:

- Final rules have no exemption for companies with market capitalization below \$200 million
- Audit Committee report to shareholders does not address GAAP - instead it requires a recommendation that the financial statements be included in the Form 10-K
- Exchanges have provided definitions of independence for audit committee members
- Exchanges will require written affirmation of compliance with independence, financial literacy, and charter rules
- SEC requires disclosure of charter if the Board of Directors has adopted one but does not require disclosure of compliance with charter
- Auditors should comment on the quality, not just acceptability of accounting principles, but are not required to indicate the aggressiveness or conservatism of accounting principles
- Quarterly reviews are required by auditors, but discussion with audit committees is only necessary if certain matters are identified during these reviews

We have included an analysis of the original ten BRC proposals to the final rules in Appendix 3.

This report summarizes the impact of the new rules in three primary categories:

- Audit Committee Composition
- Audit Committee Processes and Disclosures
- Auditor Processes

Each section provides an overview of the rules with explanatory footnotes and KPMG analysis.

KPMG’s Audit Committee Institute has interacted with more than 1,000 directors since its introduction in the spring of 1999. We would be pleased to discuss implementation issues related to these new rules with management and board members. To reach us, call toll-free at 888-KPMG-ACI (888-576-4224) or send us an e-mail at auditcommittee@kpmg.com. Dan Doheny is partner in charge of the ACI and can be reached directly at 201-505-2034.

Audit Committee Composition

Overview of Rule Changes

One of the primary goals of the BRC was to establish a high standard of qualifications for audit committee (AC) membership - all must be independent and all must be financially literate. The following table summarizes the rules required by the exchanges:

	New York Stock Exchange	NASD / AMEX
Size of audit committee	Minimum of three members	Minimum of three members
Independence Rules	All AC members must be independent	All AC members must be independent
(1) Former employees	Disqualified for three years	Disqualified for three years
(2) Immediate family members ¹	Disqualified for three years	Disqualified for three years
(3) Compensation ²	No rule	Cannot exceed \$60,000 per year
(4) Business Relationship ³	Disqualified if BOD believes relationship impairs their judgment ⁵	Disqualified if over \$200,000 or 5% ⁴
(5) Cross-compensation committee links ⁶	Not allowed	Not allowed
Non-independent board member waiver allowed for one member in exceptional circumstances ⁷	Three-year waiting period can be waived for former employee or family member	All independence rules can be waived except for current employee or family member
Financial Literacy Rules		
General requirement ⁸	All AC members are or will become financially literate	All AC members are or will become financially literate
Accounting / finance expertise	One AC member must possess ⁹	One AC member must possess ¹⁰
Written Affirmation to Exchanges		
Three members	Not Required	Required
Member independence	Required	Required
Non-independent members ¹¹	Required	Required

¹ Immediate family members are defined as a person's spouse, parents, children, siblings, mothers- fathers-in-law, sons- and daughters-in-law, brothers- and sisters-in-law, and anyone who shares such person's home.

² Compensation excludes compensation for board service.

³ Business relationships include a partner, controlling shareholder, or executive officer of an organization that has a business relationship with the company, or who has a direct business relationship with the company (e.g., a consultant).

⁴ AC members cannot be a partner, controlling shareholder, or executive officer for a company which received in excess of 5% of its gross revenue or gross revenue in excess of \$200,000 from the company.

⁵ In making a determination regarding the independence of a director, the Board of directors should consider, among other things, the materiality of the relationship to the company, to the director, and, if applicable, to the organization with which the director is affiliated.

⁶ Cross-compensation committee links occur when a director of Co. A receives compensation from Co. B and a Co. A executive serves on the compensation committee of Co. B. The Co. B executive cannot serve on the audit committee of Co. A.

⁷ Waivers may be used under exceptional and limited circumstances if the company's board of directors determines in its business judgment that membership on the committee by the individual is required by the best interests of the corporation and its shareholders.

⁸ Financial literacy is interpreted by the board of directors for NYSE companies. For NASD/AMEX, financial literacy is defined as "being able to read and understand fundamental financial statements."

⁹ Member must have accounting or related financial management expertise, as the company's board interprets such qualification in its business judgment.

¹⁰ Member must have past employment experience in finance or accounting, requisite professional certification in accounting, or any other comparable experience or background which results in the individual's financial sophistication, including being or having been a chief executive officer, chief financial officer, or other senior officer with financial oversight responsibilities.

¹¹ If it exercises the override, a company must disclose in its next annual proxy statement the nature of the relationship and the reasons for the determination that their appointment is in the best interests of the company.

	New York Stock Exchange	NASD / AMEX Written
Affirmation to Exchanges		
Financial literacy of members	Required	Required
Financial expertise of one member	Required	Required
Review of charter	Required	Required
Applicable to	All US registrants ¹²	All registrants except “small business filers” ¹³
Transition		
Audit committee size to three members	18 mo (6/01)	18 mo (6/01)
Membership independence and financial literacy	Members grandfathered until reelected or replaced	18 mo (6/01)
Composition of audit committee for IPO registrant	Two qualified directors w/in three months; three qualified directors w/in 12 months	Silent

The exchanges have adopted new rules which require that audit committees must be comprised of at least three independent, financially literate directors, one of whom must have accounting or related financial management expertise. Each exchange provides a definition of independence; in all cases these definitions disqualify former employees and their family members for three years. Directors with cross-compensation committee links are also disqualified. The NASD and AMEX disqualify directors whose personal compensation from the corporation, excluding compensation for board service, exceeds \$60,000 a year, while the NYSE has established no such guidelines. While all exchanges disqualify directors with business relationships that could impair their judgment, the NYSE allows the overall board to assess whether relationships are impaired. The NASD and AMEX disqualify directors who are partners or executives with for-profit businesses that received revenues in excess of \$200,000 or 5 percent of total revenues from the company.

The significant change from the BRC proposals was the reduction of the waiting period for independence from three to five years for former employees and family members.

KPMG Observations and Analysis

We believe that the new rules will enhance the consistency and financial competency of audit committees. Many companies have already taken a close look at the composition of their audit committees and in some cases, audit committee members will be resigning from the committee due to conflicts principally due to prohibited business relationships. In addition, some companies are in the process of searching for individuals with a higher level of financial expertise such as CEOs with financial expertise, CFOs, and retired audit partners.

Independence. Independence problems are most prevalent with respect to the business relationship rules and in particular attorneys or investment bankers whose firms provide services to the company. We are aware of instances in which former employee, family member, and cross-compensation link issues are resulting in changes to audit committee composition. In general, NYSE listed companies have more flexibility with respect to business relationships, as the board as a whole makes a subjective assessment as to whether the relationships impact the directors’ business judgment. NASD/AMEX rules are more objective - for example, an attorney practicing

¹² Foreign filers are exempt from these requirements as the Exchanges do not apply a particular standard to non-U.S. companies if the company’s corporate governance practices comply with home country law and the rules of the principal securities market for the company’s stock outside the United States.

¹³ NASD / AMEX define “small business filers” as an issuer that: (i) has revenue of less than \$25,000,000; (ii) is a U.S. or Canadian issuer; and (iii) if a majority owned subsidiary, the parent corporation is a small business issuer. Small business filers must establish an Audit Committee of at least two members, a majority of the members of which shall be independent directors.

law on their own does not meet the definition of independence if more than 5 percent or \$200,000 of their firm's revenue is generated from the company whose board they serve. This attorney would meet the NYSE definition of independence if the board determines the relationship does not impact the attorney's independent judgment.

Financial literacy. We have received many inquiries regarding the definition of financial literacy¹⁴. Most companies believe their audit committee members meet the subjective definition of financial literacy, but few audit committee members feel comfortable claiming expertise in accounting or related financial matters. Although few boards are currently identifying which individual has the required accounting or related financial management expertise, committees may need to do this in the future. Additionally, each exchange requires written affirmation that the board has determined that at least one audit committee member has expertise beyond financial literacy (see sample letter to exchanges below). We believe the ultimate definition of financial literacy and expertise will be determined within the court system. Maintaining financial literacy is required, and we believe it is prudent for audit committee members to participate in continuing education programs such as specific board room training, seminars, conferences, and roundtables.

Written Affirmation of Compliance. The BRC did not address how exchanges monitor compliance with the composition rules. Each exchange added into its rules a required written affirmation. For NYSE, this written affirmation is required for initial listings (IPOs) whenever there is a change in the composition of the audit committee and otherwise approximately once a year. NASD/AMEX rules are silent on the frequency of communication but state that each issuer must certify certain information. The following are examples of statements of compliance. The exchanges are expected to provide additional guidance on the format and timing of the affirmation statement. Any statement prepared should be reviewed by a corporation's legal counsel prior to filing it with regulatory agencies.

To NYSE

The company has established an audit committee within the Board of Directors. The audit committee consists of four members. The Board of Directors has determined that each of the four members is independent and financially literate in accordance with the rules of the NYSE. One member of the audit committee is an immediate family member of an executive officer who retired from the company two years ago. While this member does not meet the NYSE definition of independence, the Board of Directors has determined in its business judgment that membership on the audit committee is required by the best interests of the corporation and its shareholders. The Board of Directors has also determined that at least one member of the audit committee has accounting or related financial management expertise. The Board of Directors has reviewed, assessed the adequacy of, and approved the audit committee charter on an annual basis.

To NASD / AMEX

The company has established an audit committee within the Board of Directors. The audit committee consists of four members. The Board of Directors has determined that each of the four members is independent and able to read and understand fundamental financial statements. [One member of the audit committee is a partner of a law firm that provides legal services to the Company. While this member does not meet the definition of independence in accordance with NASD/AMEX Rule 4200(15)(d), the Board of Directors has determined in its business judgment that membership on the audit committee is required by the best interests of the corporation and its shareholders.] The Board of Directors has also determined that at least one member of the audit committee has past employment experience in finance or accounting. The Board of Directors has reviewed, assessed the adequacy of, and approved the audit committee charter.

¹⁴ See footnote 8.

Audit Committee Processes and Disclosures

Overview of Rule Changes

Exchange rules regarding audit committee process and SEC rules regarding disclosure are intended to clarify the role of the audit committee, enhance the effectiveness of audit committees, and further promote investor confidence in the integrity of the financial reporting process. The following table summarizes the new rules related to the audit committee processes and disclosures:

	Authoritative Body Issuing Rule			
	NYSE	NASD/ AMEX	SEC	AICPA
Audit Committee Oversight Role				
Review the audited financial statements with management			X	
Auditor discussion of SAS 61 issues including quality of company's accounting principles (see footnote 19)			X	X
Discuss auditor independence ¹⁵	X	X	X	
Recommend to BOD to include financials in the annual report ¹⁶			X	
Audit Committee Charter				
Prepare and approve formal charter ¹⁷	X	X		
Approve charter on an annual basis	X	X		
Publish charter every three years in proxy			X ¹⁸	
Quarterly reviews				
Review required			X	
Discussion of certain quarterly review findings				X
Audit Committee Disclosures				
Audit committee report to shareholders			X	
Audit committee charter review	X	X		
Audit committee charter existence			X	
Information on non-independent members	X	X	X ¹⁹	
Transition				
Charter	6 mo (6/00)	6 mo (6/00)	N/A	N/A
Quarterly review performed	3 mo (3/00)	3 mo (3/00)	3 mo (3/00)	3 mo (3/00)
Other rules complied with	1 yr (12/00)	1 yr (12/00)	1 yr (12/00)	1 yr (12/00)

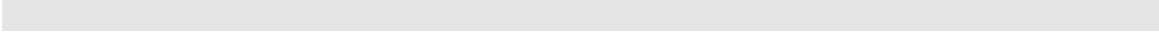
¹⁵ The audit committee is responsible to receive and evaluate a report from the outside auditor which discloses all relationships with the Company that the auditor believes may impact independence and objectivity.

¹⁶ The SEC significantly reduced the reporting due to concerns that it would expose audit committees to additional liability. The initial BRC proposal would have required that the audit committee conclude on GAAP. The initial SEC proposal recommended that the committee provide negative assurance that they were unaware of any untrue statements or omission of material fact that would keep the financial statements from being misleading.

¹⁷ Formal written charter must be approved by the full board of directors and that specifies the scope of the committee's responsibilities, and how it carries out those responsibilities, including structure, processes, and membership requirements. The charter must indicate that the outside auditor is ultimately accountable to the board of directors and the audit committee and that the audit committee is responsible to evaluate the independence of the outside auditor. KPMG has prepared an audit committee charter toolkit - contact the Audit Committee Institute for a copy.

¹⁸ The company must include a copy of the written charter, if any, as an appendix to the registrant's proxy statement, unless a copy has been included as an appendix to the registrant's proxy statement within the past three fiscal years.

¹⁹ Companies must disclose whether the audit committee members are independent, as defined in the applicable listing standards and the reasons for their appointment to the AC.



The SEC has adopted new rules related to certain audit committee processes and disclosures. Beginning after December 15, 2000, the annual proxy statement must include an audit committee report stating whether the committee has: (1) reviewed and discussed the audited financial statements with management; (2) discussed with the auditors the matters required by SAS 61; and (3) received and discussed with the auditors the independence matters required by ISB 1. The report must also state whether, based on the procedures performed, the members of the audit committee recommended to the Board of Directors that the audited financial statements be included in the Company's Annual Report on Form 10-K.

The annual proxy statement must also state whether the audit committee has adopted a written charter. A copy of this charter must be included in the proxy statement at least every three years. Annual disclosure in the proxy statement of certain information regarding non-independent directors who serve on the audit committee is also required. The exchanges also require that the audit committee adopt a charter that specifies the scope of the committee's responsibilities and auditor accountability to the board.

The companies' auditors must also complete a review of interim financial information before it is filed with the SEC and ensure the audit committee has been informed of any significant matters identified.

The SEC will require interim reviews beginning with quarters ending after March 15, 2000 and compliance with the other requirements after December 15, 2000. Accordingly, the disclosure rules will not be in effect for the 2000 proxy season. Registrants voluntarily may comply with any of the new requirements prior to the compliance dates.

KPMG Observations and Analysis

In our experience, the overriding concerns expressed by directors relate to the perception of disproportionate risks and responsibilities assumed by audit committee members. The question of personal liability comes up frequently. Director liability was addressed by many of the law firms that participated in a series of roundtables held throughout the United States and hosted by KPMG's Audit Committee Institute. Many of the law firms discussed the importance of having effective processes in place and the favorable view courts have on directors that establish and follow appropriate guidelines. The exchange rules mandate certain processes, and the SEC mandates certain disclosures.

Charters. Establishment of a meaningful, tailored charter is important for all audit committees. In response to numerous requests from clients, KPMG prepared an audit committee charter toolkit which is available to clients and friends. Each audit committee and board should update their charter at least annually and refer to it in planning each audit committee meeting. KPMG recommends that charters be reviewed by outside counsel and auditors prior to adoption. During our roundtables, several law firms noted that charters can and will be used against audit committees - caution should be taken to assure that the charter includes all required responsibilities and that all responsibilities stated within the charter are met.

Report to Shareholders. The audit committee report to shareholders was the most controversial rule proposal. The SEC made significant compromises from the original BRC recommendation (requiring a report from the audit committee on GAAP) and from its own proposal (requiring negative assurance). We believe the SEC has addressed the concerns of many parties, including KPMG, who felt the proposals created disproportionate liability for audit committee members. For most companies, the report is not required until the spring of 2001. The following is a sample report (which should be reviewed by corporate counsel before being filed).

The names of each audit committee member should follow the report:

In connection with the December 31, 2000 financial statements, the audit committee: (1) reviewed and discussed the audited financial statements with management; (2) discussed with the auditors the matters required by Statement on Auditing Standards No. 61; and (3) received and discussed with the auditors the matters required by Independence Standards Board Statement No. 1. Based upon these reviews and discussions, the audit committee recommended to the Board of Directors that the audited financial statements be included in the Annual Report on Form 10-K filed with the SEC.

Quarterly Reviews. The SEC is requiring that auditors perform timely quarterly reviews of all public companies, but there is no obligation for the audit committees to review the quarterly financial statements. If matters are identified during the interim review which would need to be communicated under SAS 61²⁰, the auditor must communicate them to the audit committee or be satisfied that they have been communicated to the audit committee by management. Therefore, quarterly communications may not be required. We believe, however, that regular, ongoing communication between management and the auditors is prudent and that audit committees should consider holding quarterly meetings to discuss financial results and review findings regardless of any SAS 61 findings.

Many audit committees are scheduling a minimum of four meetings per year to coincide with quarterly and year-end reporting; some are scheduling quarterly conference calls. In some cases, Audit Committee Chairmen have indicated that they do not want to be the only audit committee participating in conference calls (as originally suggested by the BRC), and request that the entire committee participate.

Audit Committee Oversight of External Auditors Independence. Independent Standards Board (ISB) Statement No. 1 requires that the outside auditor provide a report which discloses all relationships with the Company that the auditor believes may impact independence and objectivity. The audit committee is responsible to receive, evaluate, and discuss this report with the outside auditors. The SEC now requires that companies provide in their proxy statements (after December 15, 2000) a report from the audit committee to shareholders that discloses the audit committee has reviewed these issues with the auditor.

²⁰ SAS 61, as amended, requires that auditors discuss certain matters with audit committees of all SEC engagements. The communication may be in writing or oral and may take place before or after the financial statements are issued. Items to be communicated include:

- Discuss the auditors judgments about the quality of the accounting principals and estimates in the financial statements;
- The auditor's responsibility under Generally Accepted Auditing Standards (GAAS);
- Significant accounting policies;
- Management judgments and accounting estimates;
- Significant audit adjustments;
- Other information in documents containing audited financial statements;
- Disagreements with management – including accounting principles, scope of audit, and disclosures;
- Consultation with other accountants by management;
- Major issues discussed with management prior to retention; and
- Difficulties encountered in performing the audit.

Auditor Processes

Overview of Rule Changes

Frequent, open, and honest communication between the auditors, the audit committee, and management is important. New SEC rules mandate timely quarterly reviews of financial information by the external auditors to facilitate early identification and resolution of material accounting and reporting issues. These changes are also meant to increase the participation of the audit committee in the quarterly and year-end evaluations of the financial statements. The following table summarizes the rules required by the SEC and the AICPA:

	SEC	AICPA
Quarterly reviews		
Required prior to filing 10-Q (SAS 71) ²¹	X	X
Significant matters brought to the attention of audit committee ²²	X	
Discussion with AC should occur prior to filing of 10-Q if possible ²³		X
Cautions that all significant matters may not be identified		X
Auditor discussions concerning the quality of the accounting policies and disclosures (SAS 61)²⁴		
Involves management		X
Considers consistency, clarity, completeness, and application of accounting policies and financial statement disclosures ²⁵		X
Items with significant financial impact must also be discussed ²⁶		X
Communication must be documented by external auditor ²⁷		X
Discussions about auditor independence (ISB 1)	X	
Transition		
Perform quarterly reviews	3 mo (3/00)	
Discuss SAS 61 findings from quarterly reviews		3 mo (3/00)
Discuss quality of accounting principles		1 yr (12/00)

²¹ The independent auditors must follow “professional standards and procedures” for conducting such reviews, as established by generally accepted auditing standards.

²² The auditors must be satisfied that any significant matters identified during the interim is brought to the attention of the audit committee, either by management or the auditor. Significant matters include any significant adjustments, management judgments and accounting estimates, significant new accounting policies, or disagreements with management.

²³ A discussion of any significant matters identified during interim review should occur prior to the filing of the 10-Q or as soon thereafter as practical.

²⁴ Information relating to the auditor’s judgments about the quality, not just the acceptability, of the company’s accounting principles must be discussed with the audit committee.

²⁵ Objective criteria have not been developed to aid in the consistent evaluation of the quality of an entity’s accounting measurements and disclosures.

²⁶ Examples of items that may have significant impact on the financial statements include: the selection of new or changes to accounting policies; estimates, judgments, and uncertainties identified; unusual transactions; and the impact of the timing of recording certain transactions in the financial statements.

²⁷ The communication can be oral or written. Oral communication must be documented by the auditor in their files.

The Auditing Standards Board (ASB) of the AICPA finalized amendments to SAS 61 and SAS 71 which will require certain communication by the auditor to the audit committee and will require quarterly financial statement reviews. The ASB amended SAS No. 61, *Communication With Audit Committees*, to require that the auditor discuss with the audit committee the quality, not just the acceptability, of the company's accounting principles. This discussion should involve management and include such matters as the consistency, clarity, and completeness of accounting policies and disclosures. SAS 61 will be applicable for years ending December 31, 2000 and later.

The amendment to SAS No. 71, *Interim Financial Information*, requires the auditor to be satisfied that any significant matters identified as a result of interim review procedures have been brought to the attention of the audit committee, either by management or the auditor. If it is not possible for the auditor to make such communications prior to the filing, they should be made as soon as practicable thereafter.

SAS 71 will be applicable for quarters ending March 31, 2000 and later.

KPMG Observations and Analysis

Quarterly reviews. KPMG established a firmwide policy requiring quarterly reviews of all public clients in 1998. Review procedures are significantly less detailed than audit procedures but often indicate potential financial reporting issues. The BRC recommended quarterly communication with audit committees each quarter. The final SAS requires communication when there are findings that would be reported in a year-end SAS 61 letter. In these cases, the auditor is required to attempt to communicate these to the audit committee prior to the 10-Q being filed. We believe ongoing communication between the auditors and audit committee is necessary and quarterly communication through formal audit committee meetings or informal discussions are prudent.

Discussions on quality. Effective for periods ending on or after December 15, 2000, auditors will be required to discuss the quality of accounting principles. The final rules do not refer to discussions regarding the degree of conservatism or aggressiveness as proposed by the BRC. Instead SAS 61 suggests discussing consistency of accounting principles, clarity of disclosures, and discussion of items that have a significant impact on the representational faithfulness, verifiability, and neutrality of the accounting information. Audit committee members should recognize that each auditor will have different assessments of the quality. KPMG believes the "quality" communications should be oral and any request to reduce these to writing would result in boilerplate language and inhibit the candid exchange of opinions between the auditor, management, and the audit committee.

Appendix 1 - Finalized Rules

A - New York Stock Exchange

The following is an excerpt from New York Stock Exchange rules. Certain portions of the rules along with footnotes have been deleted. The complete set of rules is currently available at www.sec.gov.

SECURITIES AND EXCHANGE COMMISSION

(Release No. 34-42233; File No. SR-NYSE-99-39)

December 14, 1999

Self-Regulatory Organizations; Order Approving Proposed Rule Change by the New York Stock Exchange, Inc. Amending the Exchange's Audit Committee Requirements and Notice of Filing and Order Granting Accelerated Approval of Amendments No. 1 and No. 2 Thereto

I. Introduction

On September 20, 1999, the New York Stock Exchange, Inc. ("NYSE" or "Exchange") submitted to the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act") and Rule 19b-4 thereunder, a proposed rule change amending the Exchange's audit committee requirements. The *Federal Register* published the proposed rule change for comment on October 13, 1999. On October 15, 1999 and December 8, 1999, the Exchange submitted Amendments No. 1 and No. 2, respectively, to the proposed rule change. This order approves the proposed rule change and grants accelerated approval to Amendments No. 1 and No. 2. The Commission is also soliciting comment on Amendments No. 1 and No. 2 to the proposed rule change.

II. Description of the Proposed Rule Change

A. Background

In February 1999, the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees ("Blue Ribbon Committee") issued a report containing recommendations aimed at strengthening the independence of the audit committee, making the audit committee more effective, and addressing mechanisms for accountability among the audit committee, the outside auditors, and management. The Exchange distributed to its listed companies the Exchange staff's suggestions for rule changes in response to the Blue Ribbon Committee's report. The comments from the Exchange's listed companies were generally supportive of the suggestions put forth by the Exchange, with some commenters expressing concerns about "financial literacy" requirement. In response to the Blue Ribbon Committee's recommendations, the Exchange proposes to revise its listing standards regarding audit committees. The proposed rule change specifies four requirements for a qualified audit committee and defines the terms "Immediate Family" and "Affiliate" for purposes of the proposed audit committee requirements.

NYSE Listed Company Manual

* * *

Section 3

Corporate Responsibility

303.00 Corporate Governance Standards

In addition to the numerical listing standards, the Exchange has adopted certain corporate governance listing standards. These standards apply to all companies listing common stock on the Exchange. However, the Exchange does not apply a particular standard to a non-U.S. company if the company provides the Exchange with a written certification from independent counsel of the company's country of domicile stating that the company's corporate governance practices comply with home

country law and the rules of the principal securities market for the company's stock outside the United States.

303.01 Audit Committee

(A) Audit Committee Policy. Each company must have a qualified audit committee.

(B) Requirements for a Qualified Audit Committee.

- (1) Formal Charter. The Board of Directors must adopt and approve a formal written charter for the audit committee. The audit committee must review and reassess the adequacy of the audit committee charter on an annual basis. The charter must specify the following:
 - (a) the scope of the audit committee's responsibilities and how it carries out those responsibilities, including structure, processes and membership requirements;
 - (b) that the outside auditor for the company is ultimately accountable to the Board of Directors and audit committee of the company, that the audit committee and Board of Directors have the ultimate authority and responsibility to select, evaluate and, where appropriate, replace the outside auditor (or to nominate the outside auditor to be proposed for shareholder approval in any proxy statement); and
 - (c) that the audit committee is responsible for ensuring that the outside auditor submits on a periodic basis to the audit committee a formal written statement delineating all relationships between the auditor and the company and that the audit committee is responsible for actively engaging in a dialogue with the outside auditor with respect to any disclosed relationships or services that may impact the objectivity and independence of the outside auditor and for recommending that the Board of Directors take appropriate action in response to the outside auditors' report to satisfy itself of the outside auditors' independence.

- (2) Composition/Expertise Requirement of Audit Committee Members.
 - (a) Each audit committee shall consist of at least three directors, all of whom have no relationship to the company that may interfere with the exercise of their independence from management and the company ("Independent");
 - (b) Each member of the audit committee shall be financially literate, as such qualification is interpreted by the company's Board of Directors in its business judgment, or must become financially literate within a reasonable period of time after his or her appointment to the audit committee; and
 - (c) At least one member of the audit committee must have accounting or related financial management expertise, as the Board of Directors interprets such qualification in its business judgment.

- (3) Independence Requirement of Audit Committee Members. In addition to the definition of Independent provided above in (2)(a), the following restrictions shall apply to every audit committee member:
 - (a) Employees. A director who is an employee (including non-employee executive officers) of the company or any of its affiliates may not serve on the audit committee until three years following the termination of his or her employment. In the event the employment relationship is with a former parent or predecessor of the company, the director could serve on the audit committee after three years following the termination of the relationship between the company and the former parent or predecessor.
 - (b) Business Relationship. A director (i) who is a partner, controlling shareholder, or executive officer of an organization that has a business relationship with the company, or (ii) who has a direct business relationship with the company (e.g., a consultant) may serve on the audit committee only if the company's Board of Directors determines in its business judgment that the relationship does not interfere with the director's exercise of independent judgment. In making a determination regarding the independence of a director pursuant to this paragraph, the Board of Directors should consider, among other things, the materiality of the relationship to the company, to the director, and, if applicable, to the organization with which the director is affiliated.

“Business relationships” can include commercial, industrial, banking, consulting, legal, accounting and other relationships. A director can have this relationship directly with the company, or the director can be a partner, officer or employee of an organization that has such a relationship. The director may serve on the audit committee without the above-referenced Board of Directors’ determination after three years following the termination of, as applicable, either (1) the relationship between the organization with which the director is affiliated and the company, (2) the relationship between the director and his or her partnership status, shareholder interest or executive officer position, or (3) the direct business relationship between the director and the company.

- (c) Cross Compensation Committee Link. A director who is employed as an executive of another corporation where any of the company’s executives serves on that corporation’s compensation committee may not serve on the audit committee.
- (d) Immediate Family. A director who is an Immediate Family member of an individual who is an executive officer of the company or any of its affiliates cannot serve on the audit committee until three years following the termination of such employment relationship. See 303.02 for definition of “Immediate Family.”

303.02 Application of Standards

- (A) “Immediate Family” includes a person’s spouse, parents, children, siblings, mothers-in-law and fathers-in-law, sons and daughters-in-law, brothers and sisters-in-law, and anyone (other than employees) who shares such person’s home.
- (B) “Affiliate” includes a subsidiary, sibling company, predecessor, parent company, or former parent company.
- (C) Written Affirmation. As part of the initial listing process, and with respect to any subsequent changes to the composition of the audit committee, and otherwise approximately once each year, each company should provide the Exchange written confirmation regarding:
 - (1) any determination that the company’s Board of Directors has made regarding the independence of directors pursuant to any of the subparagraphs above;
 - (2) the financial literacy of the audit committee members;
 - (3) the determination that at least one of the audit committee members has accounting or related financial management expertise; and
 - (4) the annual review and reassessment of the adequacy of the audit committee charter.
- (D) Independence Requirement of Audit Committee Members. Notwithstanding the requirements of subparagraphs (3)(a) and (3)(d) of para. 303.01, one director who is no longer an employee or who is an Immediate Family member of a former executive officer of the company or its affiliates, but is not considered independent pursuant to these provisions due to the three-year restriction period, may be appointed, under exceptional and limited circumstances, to the audit committee if the company’s Board of Directors determines in its business judgment that membership on the committee by the individual is required by the best interests of the corporation and its shareholders, and the company discloses, in the next annual proxy statement subsequent to such determination, the nature of the relationship and the reasons for that determination.
- (E) “Officer” shall have the meaning specified in Rule 16a-1(f) under the Securities Exchange Act of 1934, or any successor rule.
- (F) Initial Public Offering. Companies listing in conjunction with their initial public offering (including spin-offs and carve outs) will be required to have two qualified audit committee members in place within three months of listing and a third qualified member in place within twelve months of listing.

B. Charter

The Exchange proposes to require audit committees to adopt a formal written charter that is approved by the company’s board and to review and reassess annually the adequacy of the charter. The charter must specify: (i) the scope of the audit committee’s responsibilities and how they are being carried out; (ii) the ultimate accountability of the outside auditor to the board and audit committee; (iii) the responsibility of the audit committee and board for selection, evaluation and replacement of the outside auditor; and (iv) the responsibility of the audit committee for ensuring the independence of

the outside auditor by reviewing, and discussing with the board if necessary, any relationships between the auditor and the company or any other relationships that may adversely affect the independence of the auditor.

C. Structure and Membership of the Audit Committee

The Exchange also proposes to change the structure and membership qualifications of the audit committee. Under the proposed rule change, each audit committee must have at least three independent directors, subject to a board override for one director. The board may override the three-year bar for one audit committee member after finding that an override is required in the best interests of the company and its shareholders. If it exercises the override, the company must disclose in its next annual proxy statement the nature of the relationship and the reasons for that determination. Potential candidates that are not considered independent because of a business relationship with the company or a cross compensation committee link may not be the subject of a board override.

As a result of the audit committee's responsibility for a company's accounting and financial reporting, the Exchange believes that audit committee members should have a basic understanding of financial statements. Therefore, the proposed rule change requires each audit committee member to be financially literate, or to become financially literate within a reasonable period of time after his or her appointment to the audit committee, as such qualification is interpreted by the company's board in its business judgment. Furthermore, in order to further enhance the effectiveness of the audit committee, the proposal requires at least one member of each audit committee to have accounting or related financial management expertise, as the company's board interprets such qualification in its business judgment.

[D-F are not displayed]

G. Implementation

The Exchange proposes to implement a transition period to provide its issuers with sufficient time to comply with the proposed rule change. Specifically, the Exchange proposes to: (i) "grandfather" all public company audit committee members qualified under current NYSE rules until they are re-elected or replaced; and (ii) give companies that have less than three members on their audit committees eighteen months from the date of Commission approval of this rule filing to recruit the requisite members. Issuers listed on the Exchange as of the effective date of the proposed rule change will have six months to adopt a formal written audit committee charter.

B - National Association of Securities Dealers / American Stock Exchange

The following is an excerpt from NASD / AMEX rules. While each exchange separately filed rules with the SEC, the form was virtually identical; therefore they are presented together. Certain portions of the rules along with footnotes have been deleted. The complete set of rules is currently available at www.sec.gov.

SECURITIES AND EXCHANGE COMMISSION

(Release No. 34-42231; File No. SR-NASD-99-48)

December 14, 1999

Self-Regulatory Organizations; Order Approving Proposed Rule Change by the National Association of Securities Dealers, Inc. Amending Its Audit Committee Requirements and Notice of Filing and Order Granting Accelerated Approval of Amendments No. 1 and No. 2 Thereto

I. Introduction

On September 20, 1999, the National Association of Securities Dealers, Inc. (“NASD” or “Association”), through its wholly owned subsidiary, The Nasdaq Stock Market, Inc. (“Nasdaq”), and the American Stock Exchanges (“AMEX”) (combined referred to as “the Exchange”) submitted to the Securities and Exchange Commission (“SEC” or “Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”) and Rule 19b-4 thereunder, a proposed rule change amending Nasdaq’s audit committee requirements. The *Federal Register* published the proposed rule change for comment on October 13, 1999. On November 15, 1999 and December 9, 1999, the Association submitted Amendments No. 1 and No. 2, respectively, to the proposed rule change. This order approves the proposed rule change and grants accelerated approval to Amendments No. 1 and No. 2. The Commission is also soliciting comment on Amendments No. 1 and No. 2 to the proposed rule change.

II. Description of the Proposed Rule Change

A. Background

In February 1999, the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees (“Blue Ribbon Committee”) issued a report containing recommendations aimed at strengthening the independence of the audit committee; making the audit committee more effective; and addressing mechanisms for accountability among the audit committee, the outside auditors, and management. In response to the Blue Ribbon Committee’s recommendations, the Exchange proposes to amend their listing standards regarding audit committee requirements. The proposed changes cover three general areas: 1) the definition of independence; 2) the structure and membership of the audit committee; and 3) the audit committee charter.

Rule 4200. Definitions

(a) For purposes of the Rule 4000 Series, unless the context requires otherwise:

- (15) “Independent director” means a person other than an officer or employee of the company or its subsidiaries or any other individual having a relationship which, in the opinion of the company’s Board of Directors, would interfere with the exercise of independent judgment in carrying out the responsibilities of a director. The following persons shall not be considered independent:
- (a) a director who is employed by the corporation or any of its affiliates for the current year or any of the past three years;
 - (b) a director who accepts any compensation from the corporation or any of its affiliates in excess of \$60,000 during the previous fiscal year, other than compensation for board service, benefits under a tax-qualified retirement plan, or non-discretionary compensation;
 - (c) a director who is a member of the immediate family of an individual who is, or has been in any of the past three years, employed by the corporation or any of its affiliates as an

executive officer. Immediate family includes a person's spouse, parents, children, siblings, mother-in-law, father-in-law, brother-in-law, sister-in-law, son-in-law, daughter-in-law, and anyone who resides in such person's home;

- (d) a director who is a partner in, or a controlling shareholder or an executive officer of, any for-profit business organization to which the corporation made, or from which the corporation received, payments (other than those arising solely from investments in the corporation's securities) that exceed 5% of the corporation's or business organization's consolidated gross revenues for that year, or \$200,000, whichever is more, in any of the past three years;
- (e) a director who is employed as an executive of another entity where any of the company's executives serve on that entity's compensation committee.

Rule 4310. Qualification Requirements for Domestic and Canadian Securities

To qualify for inclusion in the Exchange, a security of a domestic or Canadian issuer shall satisfy all applicable requirements contained in paragraphs (a) or (b), and (c) hereof.

(a) - (b) No change

(c) In addition to the requirements contained in paragraph (a) or (b) above, and unless otherwise indicated, a security shall satisfy the following criteria for inclusion in the Exchange:

(1) - (24)

(25) Corporate Governance Requirements

(B) Independent Directors

Each issuer shall maintain a sufficient number of independent directors on its Board of Directors to satisfy the audit committee requirement set forth in Rule 4310(c)(26)(B).

(26) Audit Committee

(A) Audit Committee Charter

Each Issuer must certify that it has adopted a formal written audit committee charter and that the Audit Committee has reviewed and reassessed the adequacy of the formal written charter on an annual basis. The charter must specify the following:

- (i) the scope of the audit committee's responsibilities, and how it carries out those responsibilities, including structure, processes, and membership requirements;
- (ii) the audit committee's responsibility for ensuring its receipt from the outside auditors of a formal written statement delineating all relationships between the auditor and the company, consistent with Independence Standards Board Standard 1, and the audit committee's responsibility for actively engaging in a dialogue with the auditor with respect to any disclosed relationships or services that may impact the objectivity and independence of the auditor and for taking, or recommending that the full board take, appropriate action to oversee the independence of the outside auditor; and
- (iii) the outside auditor's ultimate accountability to the Board of Directors and the audit committee, as representatives of shareholders, and these shareholder representatives' ultimate authority and responsibility to select, evaluate, and, where appropriate, replace the outside auditor (or to nominate the outside auditor to be proposed for shareholder approval in any proxy statement).

(B) Audit Committee Composition

- (i) Each issuer must have, and certify that it has and will continue to have, an audit committee of at least three members, comprised solely of independent directors, each of whom is able to read and understand fundamental financial statements, including a company's balance sheet, income statement, and cash flow statement or will become able to do so within a reasonable period of time after his or her appointment to the audit committee. Additionally, each issuer must certify that it has, and will continue to have, at least one member of the audit committee that has past employment experience in finance or accounting, requisite professional certification in accounting, or any other comparable experience or background which results in the individual's financial sophistication, including being or having been a chief executive officer, chief financial officer or other senior officer with financial oversight responsibilities.

- (ii) Notwithstanding paragraph (i), one director who is not independent as defined in Rule 4200, and is not a current employee or an immediate family member of such employee, may be appointed to the audit committee, if the board, under exceptional and limited circumstances, determines that membership on the committee by the individual is required by the best interests of the corporation and its shareholders, and the board discloses, in the next annual proxy statement subsequent to such determination, the nature of the relationship and the reasons for that determination.
- (iii) Exception for Small Business Filers -- Paragraphs (B)(i) and (B)(ii) do not apply to issuers that file reports under SEC Regulation S-B. Such issuers must establish and maintain an Audit Committee of at least two members, a majority of the members of which shall be independent directors.

Rule 4320. Qualification Requirements for Non-Canadian Foreign Securities and American Depository Receipts

To qualify for inclusion in The Exchange, a security of a non-Canadian foreign issuer, an American Depository Receipt (ADR) or similar security issued in respect of a security of a foreign issuer shall satisfy the requirements of paragraphs (a), (b) or (c), and (d) and (e) of this Rule.

(a) - (d) No change

(e) In addition to the requirements contained in paragraphs (a), (b) or (c), and (d), the security shall satisfy the following criteria for inclusion in The Exchange:

(1) - (20) No change

(21) Corporate Governance Requirements -- No provisions of this subparagraph or of subparagraph (24) shall be construed to require any foreign issuer to do any act that is contrary to a law, rule or regulation of any public authority exercising jurisdiction over such issuer or that is contrary to generally accepted business practices in the issuer's country of domicile. The Exchange shall have the ability to provide exemptions from the applicability of these provisions as may be necessary or appropriate to carry out this intent.

The Exchange shall review the issuer's past corporate governance activities. This review may include activities taking place while the issuer is listed on The Exchange or an exchange that imposes corporate governance requirements, as well as activities taking place after the issuer is no longer listed on The Exchange or an exchange that imposes corporate governance requirements. Based on such review, The Exchange may take any appropriate action, including placing of restrictions on or additional requirements for listing, or the denial of listing of a security if The Exchange determines that there have been violations or evasions of such corporate governance standards. Determinations under this subparagraph shall be made on a case-by-case basis as necessary to protect investors and the public interest.

(B) Independent Directors

Each issuer shall maintain a sufficient number of independent directors on its Board of Directors to satisfy the audit committee requirement set forth in Rule 4320(e)(22)(B).

(22) Audit Committee

(A) Audit Committee Charter

Each Issuer must certify that it has adopted a formal written audit committee charter and that the Audit Committee has reviewed and reassessed the adequacy of the formal written charter on an annual basis. The charter must specify the following:

- (i) the scope of the audit committee's responsibilities, and how it carries out those responsibilities, including structure, processes, and membership requirements;
- (ii) the audit committee's responsibility for ensuring its receipt from the outside auditors of a formal written statement delineating all relationships between the auditor and the company, consistent with Independence Standards Board Standard 1, and the audit committee's responsibility for actively engaging in a dialogue with the auditor with respect to any disclosed relationships or services that may impact the objectivity and independence of the auditor and for taking, or recommending that the full board take, appropriate action to oversee the independence of the outside auditor; and

- (iii) the outside auditor's ultimate accountability to the Board of Directors and the audit committee, as representatives of shareholders, and these shareholder representatives' ultimate authority and responsibility to select, evaluate, and, where appropriate, replace the outside auditor (or to nominate the outside auditor to be proposed for shareholder approval in any proxy statement).

(B) Audit Committee Composition

- (i) Each issuer must have, and certify that it has and will continue to have, an audit committee of at least three members, comprised solely of independent directors, each of whom is able to read and understand fundamental financial statements, including a company's balance sheet, income statement, and cash flow statement or will become able to do so within a reasonable period of time after his or her appointment to the audit committee. Additionally, each issuer must certify that it has, and will continue to have, at least one member of the audit committee that has past employment experience in finance or accounting, requisite professional certification in accounting, or any other comparable experience or background which results in the individual's financial sophistication, including being or having been a chief executive officer, chief financial officer or other senior officer with financial oversight responsibilities.
- (ii) Notwithstanding paragraph (i), one director who is not independent as defined in Rule 4200, and is not a current employee or an immediate family member of such employee, may be appointed to the audit committee, if the board, under exceptional and limited circumstances, determines that membership on the committee by the individual is required by the best interests of the corporation and its shareholders, and the board discloses, in the next annual proxy statement subsequent to such determination, the nature of the relationship and the reasons for that determination.
- (iii) Exception for Small Business Filers -- Paragraphs (B)(i) and (B)(ii) do not apply to issuers that file reports under SEC Regulation S-B. Such issuers must establish and maintain an Audit Committee of at least two members, a majority of the members of which shall be independent directors.

[B-D not displayed]

E. Implementation

In order to minimize disruption to existing issuer audit committees, to permit current audit committee members to serve out their terms, and to allow adequate time to recruit the requisite members, The Exchange proposes to provide its issuers listed as of the effective date of the proposed rule change eighteen months after the proposed rule change is approved by the Commission to meet the audit committee structure and membership requirements.

Additionally, The Exchange proposes that issuers listed as of the effective date of the rule change be provided six months following the date of Commission approval of the proposed rule change to adopt a formal written audit committee charter in compliance with proposed Rules 4310(c)(26)(A), 4320(e)(22)(A), or 4460(d)(1).

Further, for issuers that applied for listing prior to the effective date of the proposed rule change, The Exchange proposes that they be able to qualify for listing under the listing standards in force at the time of their application, and to receive the same grace periods provided to currently listed issuers, as described above. Also, in order to avoid prejudicing issuers that transfer to The Exchange from the American Stock Exchange and the New York Stock Exchange, The Exchange proposed that these issuers be afforded the same grace periods they would have received under their previous market's implementation schedule.

C - Securities and Exchange Commission

The following is an excerpt from Securities and Exchange Commission rules. Certain portions of the rules along with footnotes have been deleted. The complete set of rules is currently available at www.sec.gov.

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 210, 228, 229, and 240 [Release No. 34-42266; File No. S7-22-99] RIN 3235-AH83

Audit Committee Disclosure

Summary: The Securities and Exchange Commission is adopting new rules and amendments to its current rules to require that companies' independent auditors review the companies' financial information prior to the companies filing their Quarterly Reports on Form 10-Q or Form 10-QSB with the Commission, and to require that companies include in their proxy statements certain disclosures about their audit committees and reports from their audit committees containing certain disclosures. The rules are designed to improve disclosure related to the functioning of corporate audit committees and to enhance the reliability and credibility of financial statements of public companies.

Dates: Effective Date: [Insert date 30 days after publication in the *Federal Register*.] **Compliance Dates:** Registrants must obtain reviews of interim financial information by their independent auditors starting with their Forms 10-Q or 10-QSB to be filed for fiscal quarters ending on or after March 15, 2000. Registrants must comply with the new proxy and information disclosure requirements (*e.g.*, the requirement to include a report of their audit committee in their proxy statements, provide disclosures regarding the independence of their audit committee members, and attach a copy of the audit committee's charter) for all proxy and information statements relating to votes of shareholders occurring after December 15, 2000. Companies who become subject to Item 302(a) of Regulation S-K as a result of today's amendments must comply with its requirements after December 15, 2000. Registrants voluntarily may comply with any of the new requirements prior to the compliance dates.

Supplementary Information: The Commission is adopting amendments to Rule 10-01 of Regulation S-X, Item 310 of Regulation S-B, Item 7 of Schedule 14A under the Securities Exchange Act of 1934 (the "Exchange Act"), and Item 302 of Regulation S-K. Additionally, the Commission is adopting new Item 306 of Regulation S-K and Item 306 of Regulation S-B.

I. Executive Summary

We are adopting new rules and amendments to current rules to improve disclosure relating to the functioning of corporate audit committees and to enhance the reliability and credibility of financial statements of public companies. As more fully described in the Proposing Release, the new rules and amendments are based in large measure on recommendations made by the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees (the "Blue Ribbon Committee"). The new rules and amendments have been adopted in most respects as proposed, with modifications discussed below.

Audit committees play a critical role in the financial reporting system by overseeing and monitoring management's and the independent auditors' participation in the financial reporting process. We have seen a number of significant changes in our markets, such as technological developments and increasing pressure on companies to meet earnings expectations, that make it ever more important for the financial reporting process to remain disciplined and credible. We believe that additional disclosures about a company's audit committee and its interaction with the company's auditors and management will promote investor confidence in the integrity of the financial reporting process. In addition, increasing the level of scrutiny by independent auditors of companies' quarterly financial statements should lead to fewer year-end adjustments, and, therefore, more reliable financial information about companies throughout the reporting year.

Accordingly, the new rules and amendments:

- require that companies' independent auditors review the financial information included in the companies' Quarterly Reports on Form 10-Q or 10-QSB prior to the companies filing such reports with the Commission
- extend the requirements of Item 302(a) of Regulation S-K (requiring at fiscal year end appropriate reconciliations and descriptions of any adjustments to the quarterly information previously reported in a Form 10-Q for any quarter) to a wider range of companies
- require that companies include reports of their audit committees in their proxy statements; in the report, the audit committee must state whether the audit committee has: (i) reviewed and discussed the audited financial statements with management; (ii) discussed with the independent auditors the matters required to be discussed by Statement on Auditing Standards No. 61, as may be modified or supplemented; and (iii) received from the auditors disclosures regarding the auditors' independence required by Independence Standards Board Standard No. 1, as may be modified or supplemented, and discussed with the auditors the auditors' independence (see Section III.B)
- require that the report of the audit committee also include a statement by the audit committee whether, based on the review and discussions noted above, the audit committee recommended to the Board of Directors that the audited financial statements be included in the company's Annual Report on Form 10-K or 10-KSB (as applicable) for the last fiscal year for filing with the Commission
- require that companies disclose in their proxy statements whether their Board of Directors has adopted a written charter for the audit committee, and if so, include a copy of the charter as an appendix to the company's proxy statements at least once every three years;
- require that companies, including small business issuers, whose securities are quoted on The Exchange or listed on the American Stock Exchange ("AMEX") or New York Stock Exchange ("NYSE"), disclose in their proxy statements whether the audit committee members are "independent" as defined in the applicable listing standards, and disclose certain information regarding any director on the audit committee who is not "independent"; require that companies, including small business issuers, whose securities are not quoted on The Exchange or listed on the AMEX or NYSE disclose in their proxy statements whether, if they have an audit committee, the members are "independent," as defined in the NASD's, AMEX's or NYSE's listing standards, and which definition was used ; and
- provide "safe harbors" for the new proxy statement disclosures to protect companies and their directors from certain liabilities under the federal securities laws .

To provide companies with the opportunity to evaluate their compliance with the revised listing standards of the NASD, AMEX, and NYSE and to prepare for the new disclosure requirements, we are providing transition periods for compliance with the new requirements.

IV. Applicability to Foreign Private Issuers and Section 15(d) Reporting Companies

A. Foreign Private Issuers

We proposed to exclude from the new requirements foreign private issuers with a class of securities registered under Section 12 of the Exchange Act or that file reports under Section 15(d) of the Exchange Act. Foreign private issuers currently are exempt from the proxy rules, are not required to file Quarterly Reports on Form 10-Q or 10-QSB, and are subject to different corporate governance regimes in their home countries. Accordingly, we do not believe it is appropriate to extend the new requirements to foreign private issuers at this time. The Commission, however, is continuing to consider how the periodic reporting requirements for domestic companies should apply to foreign private issuers.

B. Section 15(d) Reporting Companies

As noted in the Proposing Release, companies whose reporting obligations arise solely under Section 15(d) of the Exchange Act are not required to file proxy statements with the Commission. We solicited comment on whether we should require those companies to provide the new disclosures in their Form 10-Ks or some other filing. Because we believe that the disclosures are most relevant to voting decisions on the basis of disclosure in proxy statements, and because of the nature of the

market for the securities of such companies, we are not adopting such a scheme. Accordingly, at this time we are not extending the proxy statement disclosure requirements to Section 15(d) companies.

V. Compliance Dates

Registrants must obtain reviews of interim financial information by their independent auditors starting with their Forms 10-Q or 10-QSB to be filed for fiscal quarters ending on or after March 15, 2000. Registrants must comply with the new proxy and information disclosure requirements (*e.g.*, the requirement to include a report of their audit committee in their proxy statements, provide disclosures regarding the independence of their audit committee members, and attach a copy of their audit committee's charter) for all proxy and information statements relating to votes of shareholders occurring after December 15, 2000. Companies who become subject to Item 302(a) as a result of today's amendments must comply with its requirements after December 15, 2000. Registrants voluntarily may comply with any of the new requirements prior to the compliance dates.

X. Statutory Bases and Text of Amendments

We are adopting amendments to Rules 10-01 of Regulation S-X and 14a-101 (Schedule 14A), Item 310 of Regulation S-B, and Item 302(a) of Regulation S-K, and adopting new Item 306 of Regulations S-K and S-B, under the authority set forth in Sections 2, 13, 14, and 23 of the Exchange Act.

§ 210.10-01 Interim financial statements.

- (d) Interim review by independent public accountant. Prior to filing, interim financial statements included in quarterly reports on Form 10-Q (17 CFR 249.308(a)) must be reviewed by an independent public accountant using professional standards and procedures for conducting such reviews, as established by generally accepted auditing standards, as may be modified or supplemented by the Commission. If, in any filing, the company states that interim financial statements have been reviewed by an independent public accountant, a report of the accountant on the review must be filed with the interim financial statements.

§ 228.306 (Item 306) Audit Committee Report.

- (a) The audit committee must state whether:
- (1) The audit committee has reviewed and discussed the audited financial statements with management;
 - (2) The audit committee has discussed with the independent auditors the matters required to be discussed by SAS 61, as may be modified or supplemented;
 - (3) The audit committee has received the written disclosures and the letter from the independent accountants required by Independence Standards Board Standard No. 1 (Independence Standards Board Standard No. 1, Independence Discussions with Audit Committees), as may be modified or supplemented, and has discussed with the independent accountant the independent accountant's independence; and
 - (4) Based on the review and discussions referred to in paragraphs (a)(1) through (a)(3) of this Item, the audit committee recommended to the Board of Directors that the audited financial statements be included in the company's Annual Report on Form 10-KSB (17 CFR 249.310b) for the last fiscal year for filing with the Commission.
- (b) The name of each member of the company's audit committee (or, in the absence of an audit committee, the board committee performing equivalent functions or the entire Board of Directors) must appear below the disclosure required by this Item.
- (c) The information required by paragraphs (a) and (b) of this Item shall not be deemed to be "soliciting material," or to be "filed" with the Commission or subject to Regulation 14A or 14C (17 CFR 240.14a-1 et seq. or 240.14c-1 et seq.), other than as provided in this Item, or to the liabilities of section 18 of the Exchange Act (15 U.S.C. 78r), except to the extent that the company specifically requests that the information be treated as soliciting material or specifically incorporates it by reference into a document filed under the Securities Act or the Exchange Act.
- (d) The information required by paragraphs (a) and (b) of this Item need not be provided in any filings other than a registrant proxy or information statement relating to an annual meeting of

security holders at which directors are to be elected (or special meeting or written consents in lieu of such meeting). Such information will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the registrant specifically incorporates it by reference.

§ 228.310 (Item 310) Financial Statements.

- (b) Interim Financial Statements. Interim financial statements may be unaudited; however, prior to filing, interim financial statements included in quarterly reports on Form 10-QSB (17 CFR 249.308b) must be reviewed by an independent public accountant using professional standards and procedures for conducting such reviews, as established by generally accepted auditing standards, as may be modified or supplemented by the Commission. If, in any filing, the issuer states that interim financial statements have been reviewed by an independent public accountant, a report of the accountant on the review must be filed with the interim financial statements. Interim financial statements shall include a balance sheet as of the end of the issuer's most recent fiscal quarter and income statements and statements of cash flows for the interim period up to the date of such balance sheet and the comparable period of the preceding fiscal year.

§ 229.302 (Item 302) Supplementary financial information.

- (a) Selected quarterly financial data.
- (5) This paragraph (a) applies to any registrant, except a foreign private issuer, that has securities registered pursuant to sections 12(b) (15 U.S.C. § 78l(b)) (other than mutual life insurance companies) or 12(g) of the Exchange Act (15 U.S.C. § 78l(g)).

§ 229.306 (Item 306) Audit committee report.

- (a) The audit committee must state whether:
- (1) The audit committee has reviewed and discussed the audited financial statements with management;
 - (2) The audit committee has discussed with the independent auditors the matters required to be discussed by SAS 61 (Codification of Statements on Auditing Standards, AU § 380), as may be modified or supplemented;
 - (3) The audit committee has received the written disclosures and the letter from the independent accountants required by Independence Standards Board Standard No. 1 (Independence Standards Board Standard No. 1, Independence Discussions with Audit Committees), as may be modified or supplemented, and has discussed with the independent accountant the independent accountant's independence; and
 - (4) Based on the review and discussions referred to in paragraphs (a)(1) through (a)(3) of this Item, the audit committee recommended to the Board of Directors that the audited financial statements be included in the company's Annual Report on Form 10-K (17 CFR 249.310) (or, for closed-end investment companies registered under the Investment Company Act of 1940 (15 U.S.C. § 80a-1 et seq.), the annual report to shareholders required by Section 30(e) of the Investment Company Act of 1940 (15 U.S.C. § 80a-29(e)) and Rule 30d-1 (17 CFR 270.30d-1) thereunder) for the last fiscal year for filing with the Commission.
- (b) The name of each member of the company's audit committee (or, in the absence of an audit committee, the board committee performing equivalent functions or the entire Board of Directors) must appear below the disclosure required by this Item.
- (c) The information required by paragraphs (a) and (b) of this Item shall not be deemed to be "soliciting material," or to be "filed" with the Commission or subject to Regulation 14A or 14C (17 CFR 240.14a-1 et seq. or 240.14c-1 et seq.), other than as provided in this Item, or to the liabilities of section 18 of the Exchange Act (15 U.S.C. § 78r), except to the extent that the company specifically requests that the information be treated as soliciting material or specifically incorporates it by reference into a document filed under the Securities Act or the Exchange Act.
- (d) The information required by paragraphs (a) and (b) of this Item need not be provided in any filings other than a company proxy or information statement relating to an annual meeting of security holders at which directors are to be elected (or special meeting or written consents in lieu of such meeting). Such information will not be deemed to be incorporated by reference into any

filing under the Securities Act or the Exchange Act, except to the extent that the company specifically incorporates it by reference.

§ 240.14a-101 Schedule 14A. Information required in proxy statement.

Item 7. Directors and executive officers. * * * (e)

- (3) If the registrant has an audit committee:
- (i) Provide the information required by Item 306 of Regulation S-K (17 CFR 229.306).
 - (ii) State whether the registrant's Board of Directors has adopted a written charter for the audit committee.
 - (iii) Include a copy of the written charter, if any, as an appendix to the registrant's proxy statement, unless a copy has been included as an appendix to the registrant's proxy statement within the registrant's past three fiscal years.
- (4) For registrants whose securities are listed on the New York Stock Exchange ("NYSE") or American Stock Exchange ("AMEX") or quoted on Nasdaq:
- (1) Disclose whether the members of the audit committee are independent (as independence is defined in Sections 303.01(B)(2)(a) and (3) of the NYSE's listing standards, Section 121(A) of the AMEX's listing standards, or Rule 4200(a)(15) of the National Association of Securities Dealers' ("NASD") listing standards, as applicable and as may be modified or supplemented); and
 - (2) If the registrant's Board of Directors determines in accordance with the requirements of Section 303.02(D) of the NYSE's listing standards, Section 121(B)(b)(ii) of the AMEX's listing standards, or Section 4310(c)(26)(B)(ii) or 4460(d)(2)(B) of the NASD's listing standards, as applicable and as may be modified or supplemented, to appoint one director to the audit committee who is not independent, disclose the nature of the relationship that makes that individual not independent and the reasons for the Board's determination. Small business issuers (17 CFR 228.10(a)(1)) need not provide the information required by this paragraph (e)(3)(iv)(A)(2).
 - (B) For registrants, including small business issuers, whose securities are not listed on the NYSE or AMEX or quoted on Nasdaq, disclose whether, if the registrant has an audit committee, the members are independent. In determining whether a member is independent, registrants must use the definition of independence in Sections 303.01(B)(2)(a) and (3) of the NYSE's listing standards, Section 121(A) of the AMEX's listing standards, or Rule 4200(a)(15) of the NASD's listing standards, as such sections may be modified or supplemented, and state which of these definitions was used. Whichever definition is chosen must be applied consistently to all members of the audit committee.
- (5) The information required by paragraph (e)(3) of this Item shall not be deemed to be "soliciting material," or to be "filed" with the Commission or subject to Regulation 14A or 14C (17 CFR 240.14a-1 et seq. or 240.14c-1 et seq.), other than as provided in this Item, or to the liabilities of section 18 of the Exchange Act (15 U.S.C. § 78r), except to the extent that the registrant specifically requests that the information be treated as soliciting material or specifically incorporates it by reference into a document filed under the Securities Act or the Exchange Act. Such information will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the registrant specifically incorporates it by reference.
- (6) The disclosure required by this paragraph (e)(3) need only be provided one time during any fiscal year.
- (7) Investment companies registered under the Investment Company Act of 1940 (15 U.S.C. § 80a-1 et seq.), other than closed-end investment companies, need not provide the information required by this paragraph (e)(3).

D - Auditing Standards Board

The following is an excerpt from AICPA Auditing Standards Board (ASB) rules regarding audit committee communications. The ASB issued Statement on Auditing Standards (SAS) No. 90 which amends SAS 61 and SAS 71. Certain portions of the rules have been deleted. The complete set of rules is currently available at www.aicpa.org.

Part 1 - Amendment to SAS No. 61, *Communication With Audit Committees*

1. This amendment revises SAS No. 61 (AU sec. 380.03) and adds a new paragraph to SAS No. 61 (AU sec. 380.11) to reflect recommendation number 8 of the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees in their report issued in 1999. This amendment requires auditors of Securities and Exchange Commission (SEC) clients to discuss with audit committees the auditor's judgments about the quality, and not just the acceptability, of the company's accounting principles and underlying estimates in its financial statements. The new language is shown in boldface italics. [AU sec. 380.11-.16 is renumbered 380.12-.17.]

.03 The communications may be oral or written. If information is communicated orally, the auditor should document the communication by appropriate memoranda or notations in the working papers.²⁸ When the auditor communicates in writing, the report should indicate that it is intended solely for the information and use of the audit committee or the Board of Directors and, if appropriate, management, and is not intended to be and should not be used by anyone other than these specified parties.

Auditor's Judgments About the Quality of the Entity's Accounting Principles

11. In connection with each SEC engagement (see paragraph .01), the auditor should discuss with the audit committee the auditor's judgments about the quality, not just the acceptability, of the entity's accounting principles as applied in its financial reporting. Since the primary responsibility for establishing an entity's accounting principles rests with management, the discussion generally would include management as an active participant. The discussion should be open and frank and generally should include such matters as the consistency of the entity's accounting policies and their application, and the clarity and completeness of the entity's financial statements, which include related disclosures. The discussion should also include items that have a significant impact on the representational faithfulness, verifiability, and neutrality of the accounting information included in the financial statements²⁹. Examples of items that may have such impact are the following:

- ***Selection of new or changes to accounting policies***
- ***Estimates, judgments, and uncertainties***
- ***Unusual transactions***
- ***Accounting policies relating to significant financial statement items, including the timing of transactions and the period in which they are recorded***

Objective criteria have not been developed to aid in the consistent evaluation of the quality of an entity's accounting principles as applied in its financial statements. The discussion should be tailored to the entity's specific circumstances, including accounting applications

²⁸ (Per ASB) The auditor may wish to review the minutes, if any, prepared by the audit committee for consistency with the auditor's understanding of the communications.

²⁹ (Per ASB) These characteristics of accounting information are discussed in Statement of Financial Accounting Concepts (SFAC) No. 2, Qualitative Characteristics of Accounting Information. SFAC No. 2 notes that consistently understating results or overly optimistic estimates of realization are inconsistent with these characteristics.

and practices not explicitly addressed in the accounting literature, for example, those that may be unique to an industry.

2. This amendment is effective for audits of financial statements for periods ending on or after December 15, 2000. Earlier application is permitted.

Part 2 - Amendment to SAS No. 71, *Interim Financial Information*

3. This amendment revises SAS No. 71 (AU sec. 722.25) and includes two new paragraphs (AU sec. 722.26 and .27) to reflect recommendation number 10 of the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees in their report issued in 1999. It requires auditors of SEC clients to attempt to discuss with audit committees the matters described in SAS No. 61 prior to the filing of the Form 10-Q. The new language is shown in boldface italics; deleted language is shown by strikethrough. [AU sec. 722.26–.44 is renumbered 722.28–.46.]

.25 In performing the procedures in paragraphs .13 through .19, the accountant also should consider whether any of the matters described in section 380, *Communication With Audit Committees*, as they relate to the interim financial information, ***have been identified. If such matters have been identified, the accountant*** should communicate ***them*** to the audit committee ***or be satisfied, through discussions with the audit committee, that such matters have been communicated to the audit committee by management.*** For instance, the accountant should determine that the audit committee is informed about the process used by management in formulating particularly sensitive accounting estimates or about a change in a significant accounting policy affecting the interim financial information.

.26 The objective of a review of interim financial information differs significantly from that of an audit. Therefore, any discussion of the accountant's judgments about the quality, not just the acceptability, of the entity's accounting principles as applied in its interim financial reporting would generally be limited to the impact of significant events, transactions, and changes in accounting estimates considered by the accountant in performing the procedures in paragraphs .13 through .19. Further, such interim review procedures do not provide assurance that the accountant will become aware of all matters affecting the accountant's judgments about the quality of the entity's accounting principles that would be identified as a result of an audit.

.27 When the accountant has conducted the review prior to the entity's filing of the interim financial information with a regulatory agency (such as the SEC), and has identified matters to be communicated pursuant to paragraphs .25 and .26, he or she should attempt to make such communications with the audit committee, or at least its chairman, and a representative of financial management prior to such filing. If such communications cannot be made prior to the filing, they should be made as soon as practicable in the circumstances.

4. This amendment is effective for reviews of interim financial information for interim periods ending on or after March 15, 2000. Earlier application is permitted.

Appendix 2 - Transition Timeline

We have evaluated the new audit committee regulations and have created the following transition timeline to assist audit committees in meeting their requirements:

KPMG recommendations - To do as soon as practical

- Assess audit committee member independence
 - Do all audit committee members meet the exchange definitions of independence?
 - NYSE only - the board can waive non-compliance for one former employee or family member of a former employee if it is determined to be in the best interests of the shareholders. Will the board make this determination? If not, member is disqualified upon re-election.
 - NASD/AMEX - the board can waive non-compliance for one member who does not meet the independence criteria as long as they are not a current employee if they determine a waiver is in the best interest of the shareholders. Will the board make this determination? If not, member is disqualified upon re-election.
 - If the audit committee does not have 3 independent members, consideration should be given to recruiting qualified independent members.
- Assess the audit committee financial literacy
 - Are all audit committee members financially literate?
 - If not, will they obtain financial literacy in a reasonable timeframe? If they cannot or will not, they will be disqualified upon re-election
 - Is there at least one member with accounting or related financial management expertise (for NYSE) or with past employment experience in finance or accounting (NASD/AMEX).
 - If not, the board should consider recruiting a member that has these qualifications before June 15, 2001.
- Does the audit committee have at least 3 members that are independent and financially literate?
 - If not, consider reappointing other directors that meet the criteria, or recruit new directors.

Requirements:

For quarters ending after March 15, 2000

- Auditors to perform quarterly reviews every quarter
- Significant matters (per SAS 61), if any, should be communicated to audit committees prior to 10-Q filing

Approximately June 15, 2000

- Board to approve audit committee charter and to review at least annually thereafter

For periods ending after December 15, 2000

- Audit committee to review audited financial statements with management
- Auditors to discuss quality of accounting in addition to historical SAS 61 items
- Auditors to discuss independence standards in accordance with ISB 1
- Audit committee to recommend to board that financial statements be filed with 10-K
- Audit committee to prepare report to shareholders - describe non-independent members
- Proxy statements to include report from audit committee and charter (if it has not been disclosed in past 3 years)

Approximately June 15, 2001

- Audit committee composition of 3 independent, financially literate (1 with expertise) to be finalized

Other

- Written affirmation of compliance with exchanges - dates currently unknown

- Audit committee members that do not meet independence / literacy criteria are grandfathered for NYSE until re-elected

Appendix 3 - Comparison of Rules to BRC Recommendations

Summary of BRC Comment	Juris- diction	Final Rules	Final Rules
<p>1. The Exchanges should establish new criteria for defining independence as it relates to audit committee members. Relationships precluding independence include (A) director employed within last 5 years (B) director accepting compensation other than board compensation (C) director family member employed within 5 years (D) director employer accepting significant payment in last 5 years (E) company management may not be represented on the compensation committee of directors' employer (cross compensation committee link). Provisions for recommendations 1, 2, 3 apply to companies with capitalization over \$200 million.</p>	NYSE / NASD/ AMEX	<p>NYSE (A) – former employees and officers should be independent after 3 years (versus 5) (B) – not addressed (C) former employee's families should be independent after 3 years (versus 5) (D) audit committee members may not have a significant business relationship with corporation if the board determines that it will interfere with the members exercise of good judgement (E) company management may not be represented on the compensation committee of directors' employer. Annual written affirmation of compliance with these rules required.</p> <p>NYSE - Rejects the \$200 million capitalization exemption – recommendations apply to all registrants.</p>	<p>NASD/AMEX (A) Employees and officers independent after 3 years (B) Compensation allowed as long as it is not in excess of \$60,000 (C) Former employees families independent after 3 years (D) Audit committee members cannot be a partner, controlling shareholder or executive officer for a company which received in excess of 5% of its gross revenue or gross revenue in excess of \$200,000 from the corporation (E) company management may not be represented on the compensation committee of directors' employer.</p> <p>NASD/AMEX - Provisions for independence apply to all SEC entities however other rule changes would not apply to "Small Business Filers".</p>
<p>2. The Exchanges should require that each listed company have an audit committee consisting solely of independent directors. Certain independence rules could be overridden by the board if disclosed in the proxy statement.</p>	NYSE / NASD/ AMEX/ SEC	<p>NYSE - Audit committee members must be independent and without business relationships that could impair their independence although in certain circumstances a board override is allowed for one member of the audit committee if it is in the "best interests" of the corporation. The board override could waive the three year waiting period for A and C above and allows the board to determine if relationships impair independence (which will then be disclosed). Annual written affirmation of compliance with these rules required. SEC - requires disclosure in the proxy statement if all audit committee members are independent and certain information regarding non-independent directors who serve on the committee.</p>	<p>NASD/AMEX - Audit committee members must be independent and without business relationships that could impair their independence however one non-independent director (Board override) allowed if it is in the corporation's best interest and it is disclosed in the next proxy statement. SEC - requires disclosure in the proxy statement if all audit committee members are independent and certain information regarding non-independent directors who serve on the committee.</p>
<p>3. The NYSE and NASD should require that all listed companies have audit committees which consist of a minimum of three directors, each of which is financially literate, one with accounting or related financial management expertise.</p>	NYSE / NASD/ AMEX	<p>NYSE requires and clarifies that it is up to each board to define financial literacy. Annual written affirmation of compliance with these rules required.</p>	<p>NASD/AMEX requires and provides a definition of financially literate as being able to read and understand fundamental financial statements. Certification of compliance with this requirement is needed.</p>
<p>4. The NYSE and NASD should require that each listed company adopt a formal written charter to be approved by the overall Board of Directors and that this charter should be reviewed annually.</p>	NYSE / NASD/ AMEX	<p>NYSE, NASD, and AMEX require the audit committee to: (1) adopt a formal written charter that is approved by the full Board of Directors and that specifies the scope of the committee's responsibilities, and how it carries out those responsibilities, including structure, processes, and membership requirements; and (2) review and reassess the adequacy of the audit committee's charter on an annual basis. NYSE requires annual written affirmation of compliance.</p>	
<p>5. The SEC should require each listed company to disclose compliance with its charter annually and to publish the full charter at least triennially</p>	SEC	<p>Effective after December 15, 2000, the SEC requires that companies disclose in their proxy statements whether the audit committee has a written charter, and file a copy of their charter with the proxy statement every three years - it does not require a statement regarding compliance with charter.</p>	
<p>6. The Exchanges should require each listed company to adopt a charter that states that the outside auditor is accountable to the Board of Directors and the audit committee.</p>	NYSE / NASD/ AMEX	<p>NYSE, NASD, and AMEX requires.</p>	

Summary of BRC Comment	Juris- diction	Final rules	Final rules
7. The Exchanges should require that audit committee charters of listed companies specify that the audit committees are responsible for ensuring receipt of a report from the outside auditor which discloses all relationships with Company that may impact independence and objectivity	NYSE / NASDAQ/ AMEX	NYSE, NASD, and AMEX requires.	
8. Generally accepted auditing standards (GAAS) should require the outside auditor to discuss the quality, not just acceptability of accounting principles.	AICPA	AICPA has amended SAS 61 effective December 31, 2000 - Communication with Audit Committees - to require auditors to discuss with the audit committee the auditors' judgment about the quality, and not just acceptability of the company's accounting principles as applied in its financial reporting. This discussion should involve management and include such matters as the consistency, clarity, completeness and application of accounting policies and disclosures. This discussion should include items that have a significant impact of the accounting information included in the financial statements including: selection or changes in accounting policies; estimates, judgements and uncertainties; unusual transactions; and the impact of the timing of recording certain transactions. Objective criteria to aid in the evaluation of the quality of the accounting principles have not been developed but should be tailored to an entity's specific circumstances. Oral communication must be documented by the auditor in their workpapers	
9. The SEC should require a letter from the audit committee to shareholders describing the procedures they performed and their conclusion that the financial statements are in accordance with GAAP in all material respects.	SEC	Effective after December 15, 2000, the SEC requires that companies provide in their proxy statements a report from the audit committee that discloses whether the audit committee has reviewed the financial statements with management and discussed SAS 61 and ISB 1 (auditor independence) with the auditors, and if it recommended to the Board of Directors that the audited financial statements be included in the Annual Report on Forms 10-K and 10-KSB for filing with the Commission. Proposal does not require any additional description of the procedures performed and does not require any statement on GAAP.	
10. The SEC should require that SAS 71 quarterly reviews be performed for all companies and that the results be discussed with the audit committee chairman prior to filing the Form 10-Q.	AICPA / SEC	SEC requires that companies interim financial statements be reviewed by independent auditors before companies file their Form 10-Q . AICPA has amended SAS 71 to require that auditors be satisfied that any significant matters identified as a result of the interim review procedures be brought to the attention of the audit committee, either by management or the auditor. This communication, including significant adjustments, management judgments and accounting estimates, significant new accounting policies or disagreements with management, that had a significant impact on the interim financial information, should occur prior to the filing of the 10-Q or as soon thereafter as practical. The amendment cautions that all matters that may impact the auditor's judgement about the quality of the entity's accounting principles may not be identified during the performance of interim review procedures. SEC and AICPA changes are effective March 31, 2000.	
Transition period not addressed		NYSE/NASD/AMEX - Audit committee members "grandfathered" until they are re-elected or replaced. Corporations have 18 months to increase size of audit committee to at least 3 members.	SEC - all rules effective after December 15, 2000 except for the quarterly review requirement which is effective as of March 31, 2000. AICPA - all rules effective December 31, 2000 except for the quarterly review requirement which is effective as of March 31, 2000.

Appendix 4 - KPMG Audit Committee Institute- A Resource for Directors

Recognizing the importance of audit committees, KPMG has created the Audit Committee Institute to serve and educate committee members. Historically, audit committees have been largely on their own to keep pace with rapidly changing information related to governance, audit issues, accounting and financial reporting, and even legal issues. Wholly sponsored by KPMG, the Institute provides complimentary guidance and increases awareness for corporate audit committee members, who need to keep up with their evolving responsibilities. Board members can turn to the Institute at any time for help and advice or to share knowledge. Initiatives include:

Roundtables:

Scheduled twice a year, these two- to three-hour sessions allow directors to enhance their knowledge and help them maintain financial literacy as required by the new audit committee regulations, network with other directors and share common experiences. Each roundtable focuses on topics of interest to directors, including financial reporting, personal liability, enforcement action case studies, etc. The following summarizes the locations as well as the law firms and universities that have teamed up with KPMG:

<u>Location</u>	<u>Law Firm</u>	<u>University</u>
Atlanta	Alston & Bird	University of Georgia
Charlotte	Robinson, Bradshaw & Hinson	Duke University
Chicago	Sidley and Austin	University of Chicago
Dallas	Haynes and Boone	Southern Methodist University
Houston	Fulbright and Jaworski	University of Houston
Los Angeles	Gibson, Dunn & Crutcher	University of Southern California
New York	Wachtell, Lipton, Rosen & Katz	New York University Law School
San Diego	Pillsbury, Madison & Sutro	Corporate Directors Forum
San Francisco	Brobeck Phleger & Harrison LLP	University of California - Berkley
Silicon Valley	Wilson Sonsini Goodrich & Rosati	Stanford University Law School
Washington DC	Holland and Knight	George Washington University

The Audit Committee Institute is in the process of finalizing the locations and dates for the next roundtable series that will occur in April - May 2000. Based on the success of the last roundtable series, we will be expanding the series to include additional cities. The topic for the next roundtable will be *Managing Expectations versus Managing Earnings - What is the Board's Role?*. Invitations will be sent in February 2000 and the dates and locations will also be posted on our Roundtable Web Site at <http://www.us.kpmg.com/roundtables>.

Industry Leadership:

The Audit Committee Institute has teamed up with associations focused on serving and educating directors including The Conference Board, National Association of Corporate Directors, the Center for Board Leadership, Board Member, and Directors Roundtable. The Audit Committee Institute has made numerous presentations to other governance and industry associations.

Communications:

Drawing upon KPMG's resources, the Institute offers audit committee members a support mechanism previously unavailable. Our commitment includes the 73-page book *Shaping the Audit Committee Agenda*, which examines current issues in the business marketplace and addresses the roles and responsibilities of audit committees. We also publish, on a quarterly basis, the Audit Committee Update which examines technical issues of concern to audit committee members including current developments in accounting and auditing. Free copies of these documents can be obtained by contacting the Institute.

In addition, the Institute produces periodic technical analysis and tools for audit committee members and we will launch in February 2000 the first Web site dedicated to audit committee issues at <http://www.us.kpmg.com/auditcommittee>.

Contact Information:

A number of other programs and initiatives are under development. If you would like to discuss issues regarding audit committees, or if you would like to meet with a KPMG partner, please contact us. For more information or assistance, please contact:

KPMG's Audit Committee Institute
300 Tice Road
Woodcliff Lakes, NJ 07675

Dan Doheny
Partner in Charge
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You can also reach the Institute by calling 1-877-KPMG-ACI (1-877-576-4224) or through e-mail at auditcommittee@kpmg.com.