

the **Federal Register** on April 16, 2004,¹ and the Commission received 31 comment letters. For the reasons discussed below, the Commission is granting approval of the proposed standard.

II. Description

The Act establishes the PCAOB to oversee the audits of public companies and related matters, to protect investors, and to further the public interest in preparation of informative, accurate and independent audit reports.² Section 103(a) of the Act directs the PCAOB to establish auditing and related attestation standards, quality control standards, and ethics standards to be used by registered public accounting firms in the preparation and issuance of audit reports as required by the Act or the rules of the Commission. The Board has defined the term "auditing and related professional practice standards" to mean the standards established or adopted by the Board under section 103(a) of the Act.

Section 404 of the Act requires that registered public accounting firms attest to and report on an assessment of internal control made by management, and that such attestation "shall be made in accordance with standards for attestation engagements issued or adopted by the Board." The Board's proposed Auditing Standard No. 2 provides the professional standards and related performance guidance for independent auditors to attest to, and report on, management's assessment of the effectiveness of internal control over financial reporting under section 404 of the Act. A significant aspect of this proposed standard is the requirement of the independent auditor to attest on two items. The auditor has to evaluate management's assessment process to be satisfied that management has an appropriate basis for its conclusion. Additionally, the auditor must test and evaluate both the design and the operating effectiveness of internal control to be satisfied that management's conclusion is correct and, therefore, fairly stated. The auditor's report on internal control over financial reporting will express two opinions—an opinion on whether management's assessment of the effectiveness of internal control over financial reporting as of the end of the most recent fiscal year is fairly stated, and an opinion on whether the company has maintained effective internal control over financial reporting as of that date.

III. Discussion

The Commission received 31 comment letters in response to its request for comments on Auditing Standard No. 2. The comment letters came from issuers, registered public accounting firms, professional associations and others. In general, issuers expressed opposition to the proposed standard, and accounting firms, professional associations, and others expressed support for the proposed standard. Most commenters, irrespective of affiliation or position on the proposed standard, recommended that the Commission and the PCAOB provide additional guidance with respect to a number of different issues. Several commenters recommended that the Commission limit the scope of management's assessment of the effectiveness of internal control over financial reporting by excluding entities that are consolidated but over which the issuer lacks control.

Issuers and many of the professional associations also expressed concern with the cost of compliance in terms of management time, consultant fees and audit fees. One commenter requested that the PCAOB closely monitor the impact of the proposed standard on small and medium-sized companies. Other requests included clarifying that an adverse internal control report would not of itself result in regulatory action; delaying the effective date of the proposed standard; providing a one-year deferral to issuers that meet the definition of an accelerated filer for the first time in 2004; and deferring the accelerated filing date for Forms 10-K filed for year-end 2004. The PCAOB gave careful consideration to the issues raised by these commenters in the course of revising the proposed standard prior to its adoption by the Board. The resulting standard is a reasonable exercise of the Board's standards-setting authority under the Act.

IV. Conclusion

On the basis of the foregoing, the Commission finds that proposed Auditing Standard No. 2 is consistent with the requirements of the Act and the securities laws and is necessary and appropriate in the public interest and for the protection of investors.

It is therefore ordered, pursuant to Section 107 of the Act and Section 19(b)(2) of the Exchange Act, that proposed Auditing Standard No. 2, *An Audit of Internal Control Over Financial Reporting Performed in Conjunction With an Audit of Financial Statements* (File No. PCAOB-2004-03) be and hereby is approved.

By the Commission.

Margaret H. McFarland,
Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-49877; File No. SR-CBOE-2004-05]

Self-Regulatory Organizations; Order Granting Accelerated Approval of Proposed Rule Change and Amendment Nos. 1 and 2 Thereto and Notice of Filing and Order Granting Accelerated Approval of Amendment No. 3 Thereto by the Chicago Board Options Exchange, Inc. Relating to the Relocation of an Entire Trading Station's Securities to Another Trading Station

June 16, 2004.

I. Introduction

On January 28, 2004, the Chicago Board Options Exchange, Inc. ("CBOE" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder,² a proposed rule change to amend CBOE Rules 8.84 and 8.95 to transfer the authority to approve the relocation of an entire trading station's securities to another trading station that is operated by the same DPM organization to the MTS Committee from the Allocation Committee. CBOE filed Amendment No. 1 and 2 on March 15, 2004,³ and May 6, 2004,⁴ respectively. The proposed rule change and Amendments Nos. 1 and 2 were published for comment in the **Federal Register** on May 19, 2004.⁵ CBOE filed Amendment No. 3 on May 19, 2004.⁶ No

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See letter from Patrick Sexton, Assistant General Counsel, CBOE, to Christopher Solgan, Attorney, Division of Market Regulation ("Division"), Commission, dated March 12, 2004 ("Amendment No. 1").

⁴ See letter from Patrick Sexton, Assistant General Counsel, CBOE, to Christopher Solgan, Attorney, Division, Commission, dated May 5, 2004 ("Amendment No. 2").

⁵ See Securities Exchange Act Release No. 49687 (May 12, 2004), 69 FR 28959.

⁶ See letter from Patrick Sexton, Assistant General Counsel, CBOE, to Christopher Solgan, Attorney, Division, Commission, dated May 18, 2004 ("Amendment No. 3"). In Amendment No. 3, CBOE amended CBOE Rule 8.84 to clarify that the MTS Committee may determine whether to relocate an entire trading station's securities to another trading station that is operated by the same DPM, pursuant to a request from a DPM organization or on the Committee's own initiative. CBOE also requested

¹ Release No. 34-49544 (April 8, 2004); 69 FR 20672 (April 16, 2004).

² Section 101(a) of the Act.

comments were received on the proposed rule change and Amendments Nos. 1 and 2. This order approves the proposed rule change and Amendments Nos. 1 and 2 on an accelerated basis and issues notice of filing and approves Amendment No. 3 on an accelerated basis.

II. Description of the Proposal

CBOE proposed to amend CBOE Rules 8.84 and 8.95 to transfer the authority to approve the relocation of an entire trading station's securities to another trading station that is operated by the same DPM organization to the MTS Committee from the Allocation Committee. Specifically, CBOE proposed to add a new interpretation to CBOE Rule 8.84 which states that it shall be the responsibility of the MTS Committee to determine whether to relocate all of the securities traded at a trading station operated by a DPM organization to another trading station operated by the same DPM. Interpretation .01 to CBOE Rule 8.84 also states that in making such a determination, the MTS Committee should evaluate whether the change is in the best interest of the Exchange, and that the Committee may consider any information that it believes will be of assistance to it. Factors to be considered include, but are not limited to, any one or more of the following: Performance, operational capacity of the Exchange or the DPM, efficiency, number and experience of personnel of the DPM who will be performing functions related to the trading of the applicable securities, number of securities involved in the relocation, number of market-makers affected by the relocation of the securities, and trading volume of the securities.

Under Interpretation .01(b) to CBOE Rule 8.84, before the MTS Committee decides whether to relocate all of a trading station's securities pursuant to Interpretation .01(a) to CBOE Rule 8.85, it must notify the DPM organization and trading crowds that may be affected. Interpretation .01(b) also states that the MTS Committee shall convene one or more informal meetings with the affected DPM and trading crowds to discuss the matter, or provide the interested DPM and trading crowds with the opportunity to submit a written statement to the MTS Committee. Under Interpretation .01(a) to CBOE Rule 8.84, the MTS Committee may forego notice to the interested DPM and trading crowds only if expeditious action is required. Expeditious action may be

required during unusual circumstances such as, for example, extreme market volatility. Expeditious action may also occur if there is another situation that would similarly require urgent action.

Finally, DPMs and members of the trading crowd retain the right to appeal, if economically aggrieved by a MTS Committee decision under this proposed rule change. The appeal process is also available if the MTS Committee takes expeditious action.

III. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 3, including whether Amendment No. 3 is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-CBOE-2004-05 on the subject line.

Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609.

All submissions should refer to File Number SR-CBOE-2004-05. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Section, 450 Fifth Street, NW., Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions

should refer to File Number SR-CBOE-2004-05 and should be submitted on or before July 14, 2004.

IV. Discussion

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.⁷ In particular, the Commission believes that the proposed rule change is consistent with section 6(b)(5) of the Act,⁸ which requires, among other things, that the rules of an exchange be designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market, and to protect investors and the public interest. Specifically, the Commission believes it is reasonable to transfer the authority to determine the relocation of all of the securities traded at a particular trading station operated by a DPM organization to another trading station operated by the same DPM organization from the Exchange's Allocation Committee to the MTS Committee. The Commission believes that such determinations are properly within the MTS Committee's authority because they may impact the operational performance and market performance of the DPM.

The Commission believes that the factors to be considered by the MTS Committee in making DPM consolidation decisions, set forth in Interpretation .01(a) to CBOE Rule 8.84, are consistent with the Act. The Commission notes that these factors are intended to relate to, and be more descriptive of, the factors that the Allocation Committee considered in making similar decisions. The Commission believes that the proposed rule change gives the MTS Committee the flexibility to consider the appropriate factors for a determination to consolidate a DPM's trading location and alerts the CBOE membership of the factors that are considered important in making such a determination.

The Commission notes that CBOE has established procedural safeguards for its members. For example, Interpretation .01(a) to CBOE Rule 8.24 requires that the MTS Committee provide notice to the DPM and trading crowds potentially affected by the relocation of securities, and provide them the opportunity to participate in an informal meeting with the MTS Committee or submit a written

⁷ In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

⁸ 15 U.S.C. 78f(b)(5).

that the Commission approve the proposed rule change on an accelerated basis.

statement concerning the matter. The Commission also notes that any person economically aggrieved by a decision made under Interpretation .01 to CBOE Rule 8.84 has the right to a formal hearing, with the assistance of counsel, before CBOE's Appeals Committee. Moreover, decisions of the Appeals Committee may be appealed to the CBOE's Board of Directors.⁹

The Commission notes that CBOE believes that MTS Committee determinations to consolidate DPM trading locations should have a positive impact on the DPM trading those options classes, the trading crowds, and other market participants. In addition, CBOE has represented that CBOE trading crowd members, including market makers, should continue to be able to move freely among the trading crowds to which they are appointed on the CBOE trading floor. Therefore, members of the trading crowd should continue to be able to trade their assigned option classes even if those options classes are moved to another trading station due to the consolidation of a DPM's options classes.¹⁰ Further, the Commission notes that the trading crowd would retain appeal rights under Chapter XIX of the CBOE Rules if they were economically aggrieved by an MTS Committee decision.

The Commission finds good cause for accelerating approval of the proposed rule change and Amendment Nos. 1, 2, and 3 thereto prior to the thirtieth day after publication in the **Federal Register**. The Commission notes that the proposed rule change and Amendment Nos. 1 and 2 thereto were noticed for the full comment period and that no comments were received. The Commission also notes that the amendments merely provided additional description and detail to the proposed rule change. The Commission believes that accelerated approval will permit the MTS Committee to begin to consider pending requests to relocate an entire trading station's securities to another trading station that is operated by the same DPM organization in a timelier manner. For these reasons, the Commission finds good cause exists, consistent with sections 6(b)(5)¹¹ and 19(b)(2) of the Act,¹² to approve the proposed rule change and Amendment

Nos. 1, 2, and 3 thereto on an accelerated basis.

V. Conclusion

For the foregoing reasons, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and rules and regulations thereunder.

It is therefore ordered, pursuant to section 19(b)(2) of the Act,¹³ that the proposed rule change (SR-CBOE-2004-05) and Amendment Nos. 1, 2, and 3 thereto are approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁴

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-49880; File No. SR-CBOE-2004-15]

Self-Regulatory Organizations; Order Granting Approval of a Proposed Rule Change and Amendment No. 1 Thereto by the Chicago Board Options Exchange, Inc. Relating to Automatic Executions for Underlying Specialists

June 17, 2004.

On March 2, 2004, the Chicago Board Options Exchange, Inc. ("CBOE" or "Exchange") filed with Securities and Exchange Commission ("Commission") the proposed rule change, pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder,² to amend CBOE Rule 6.13 relating to access to the automatic execution feature of its Hybrid System. On April 28, 2004, the CBOE submitted Amendment No. 1 to the proposed rule change.³ The proposed rule change, as amended, was published for comment in the **Federal Register** on May 13, 2004.⁴ The Commission received no comment letters on the proposal. This order

¹³ 15 U.S.C. 78s(b)(2).

¹⁴ 17 CFR 200.30-3(a)(12).

¹⁵ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See letter from Steve Youhn, Counsel, CBOE, to Deborah Flynn, Assistant Director, Division of Market Regulation ("Division"), Commission, dated April 27, 2004 ("Amendment No. 1"). Amendment No. 1 clarified the access to the Exchange's automated execution system for stock exchange specialists' orders in options classes overlying stocks in which they are not specialists.

⁴ See Securities Exchange Act Release No. 49659 (May 6, 2004), 69 FR 26627.

approves the proposed rule change, as amended.

The Exchange currently trades equity options, as well as index and ETF options on the CBOE Hybrid System ("Hybrid").⁵ Hybrid merges the electronic and open outcry trading models, offering CBOE market makers the ability to stream electronically their own market quotes.

CBOE Rule 6.13 governs Hybrid's automatic execution ("auto-ex") feature. Currently, CBOE Rule 6.13(b)(i)(C)(ii) allows the appropriate floor procedure committee ("FPC") to determine whether to provide all market makers and specialists, whether on an options or stock exchange, with auto-ex access to CBOE's markets. The Exchange proposes to amend CBOE Rule 6.13 to allow the FPC to provide different levels of auto-ex access to: (i) Options exchange market makers and specialists (collectively, "options market makers"); and (ii) stock exchange specialists.

The appropriate FPC would have the ability to allow options exchange market makers to have auto-ex access while stock exchange specialists would not have auto-ex access. Alternatively, the appropriate FPC may determine to set the auto-ex eligible order size level higher for options market makers than the corresponding order size level for stock exchange specialists. The proposal applies only to stock exchange specialists with respect to their options transactions in classes overlying stocks in which they are specialists. Further, the Exchange states that proposed CBOE Rule 6.13(b)(i)(C)(ii)(A) and (B) would enable the appropriate FPC to make the access determinations on a class-by-class basis.

Moreover, specialists' orders in their non-specialty stocks would be treated in the same manner as orders of broker-dealers that are not market makers or specialists on an options exchange and thus would be eligible for automatic execution in accordance with CBOE Rule 6.13(b)(i)(C)(i).⁶ The proposed rule change would not affect a responsible broker-dealer's firm quote obligations to broker-dealer orders (which includes options market makers and stock specialists), which will remain at one contract. Similarly, the proposal does not affect the auto-ex access currently available to public customer and non-market-maker/specialist broker-dealer

⁵ See Securities Exchange Act Release Nos. 47959 (May 30, 2003), 68 FR 34441 (June 9, 2003) ("Hybrid Release"), and 48953 (December 18, 2003), 68 FR 75004 (December 29, 2003).

⁶ See Amendment No. 1, *supra* note 3.

⁹ See Chapter XIX of the CBOE's Rules.

¹⁰ Specifically, CBOE market makers are able to move freely around the trading floor, if the market makers execute at least 75% of their total contract volume in their appointed classes. See Interpretation .03A to CBOE Rule 8.7.

¹¹ 15 U.S.C. 78f(b)(5).

¹² 15 U.S.C. 78s(b)(2).