

**MEMO# 15964**

April 29, 2003

## **PCAOB ADOPTS FEE PROPOSAL; SEC RECOGNIZES PCAOB**

[15964] April 29, 2003 TO: ACCOUNTING/TREASURERS MEMBERS No. 23-03 CLOSED-END INVESTMENT COMPANY MEMBERS No. 39-03 SEC RULES MEMBERS No. 54-03 SMALL FUNDS MEMBERS No. 20-03 UNIT INVESTMENT TRUST MEMBERS No. 15-03 VARIABLE INSURANCE PRODUCTS ADVISORY COMMITTEE No. 1-03 RE: PCAOB ADOPTS FEE PROPOSAL; SEC RECOGNIZES PCAOB As we recently informed you, the Public Company Accounting Oversight Board proposed rules to establish the accounting support fee required under the Sarbanes-Oxley Act (the "Act") to fund the Board's operations.<sup>1</sup> The PCAOB recently adopted, and submitted to the SEC for approval, its accounting support fee rule proposal.<sup>2</sup> We are pleased to report that the final rule adopted by the PCAOB, consistent with recommendations submitted by the Institute, assesses investment companies at a substantially reduced fee rate. Separately, as required by the Act, the Commission has issued two orders regarding the PCAOB. The first order recognizes the PCAOB as having taken actions necessary to fulfill its obligations under the Act.<sup>3</sup> The second order recognizes the PCAOB's adoption of generally accepted auditing standards as interim auditing standards to be followed by accounting firms in connection with the preparation or issuance of any audit report.<sup>4</sup>

**A. Accounting Support Fee**

**1. Issuers Subject to the Fee** Once each year, the Board will compute the accounting support fee. The accounting support fee will be equal to the Board's budget for that year, as approved by the SEC, less the amount of registration fees collected from public accounting firms during the preceding year. In order to allocate the accounting support fee, issuers will be divided into four classes:

**1** See Memorandum No. 15772, dated March 19, 2003. **2** Establishment of Accounting Support Fee, PCAOB Release No. 2003-003 (April 18, 2003) ("Adopting Release"). The Adopting Release is available at <http://www.pcaobus.org/pcaob1/Rules/Release2003-003.pdf>. **3** Order Regarding Section 101(d) of the Sarbanes-Oxley Act of 2002, Securities Act of 1933 Release No. 8223 (April, 25, 2003). This release is available at the SEC's website at <http://www.sec.gov/rules/other/33-8223.htm>. **4** Order Regarding Section 103(a)(3)(B) of the Sarbanes-Oxley Act of 2002, Securities Act of 1933 Release No. 8222 (April 25, 2003). This release is available at the SEC's website at <http://www.sec.gov/rules/other/33-8222.htm>.

**1.** All issuers whose average, monthly U.S. equity market capitalization during the preceding calendar year, based on all classes of common stock, is greater than \$25 million and whose share price on a monthly, or more frequent basis, is publicly available ("Equity Issuer Class"); **2.** Registered investment companies and issuers that have elected to be regulated as business development companies whose average, monthly market capitalization (or net asset value), during the preceding calendar year, is greater than \$250 million and whose share price (or net asset value) on a monthly, or more frequent basis, is publicly available ("Investment Company Issuer Class"); **3.** All issuers that (i) have a basis, under a Commission rule or pursuant to other action of the Commission or its staff, not to

file audited financial statements, (ii) are employee stock purchase, savings and similar plans, interests in which constitute securities registered under the Securities Act of 1933 or (iii) are subject to the jurisdiction of a bankruptcy court and satisfy the modified reporting requirements of Commission Staff Legal Bulletin No. 2 ("Issuers Permitted Not to File Audited Financial Statements"); and 4. All other issuers (i.e., issuers that do not fall in classes one, two or three) ("All Other Issuers Class"). In the case of an investment company with multiple series, the net asset value of all series in the company would be aggregated to determine whether the \$250 million threshold has been exceeded. A company's status as an issuer within the classes will be determined as of the date on which the amount of the annual accounting support fee is set. Companies that are not issuers on that date will not be required to pay any fee during the year. Unit investment trusts that have not filed or updated a registration statement that became effective during the preceding year are included in the Issuers Permitted Not to File Audited Financial Statements class. The Adopting Release indicates that market capitalization or net asset value data may not be available for certain issuers, such as unit investment trusts and insurance company separate accounts. The final rule explicitly excludes from the fee allocation issuers whose market capitalization or net asset value is not reported on a monthly or more frequent basis.

2. Allocation of the Accounting Support Fee to Issuers The accounting support fee will be allocated among the issuers in the four classes in the following manner:

1. Each company in the Equity Issuer Class and the Investment Company Issuer Class will be allocated an amount equal to the accounting support fee, multiplied by a fraction. The numerator of the fraction will be the issuer's average monthly market capitalization during the preceding calendar year. The denominator will be the sum of the average monthly market capitalizations of all Equity and Investment Company Issuers. For purposes of this allocation, however, the market capitalization of an investment company issuer will be ten percent of the investment company's net asset value.
2. All issuers in the other two classes – Issuers Permitted Not to File and All Other Issuers – will be allocated a share of zero. Issuers will be required to pay their allocated shares of the accounting support fee, rounded to the nearest hundred. Accordingly, issuers whose shares of the accounting support fee are less than \$50 will have their shares rounded to zero and will not be assessed a fee. We estimate that investment company issuers will pay an accounting support fee of \$300 or \$400 per billion in fund net assets.
3. Notice of Allocation and Collection of Amount Due After the annual accounting support fee is determined, the Board will send a notice to each issuer to which a share of the fee has been allocated. Notices will be sent either electronically or by first class mail to the address shown on the issuer's most recent periodic report filed with the SEC. We understand that the Board plans to send fee notices to issuers in the next several months. Payment will be due on the 30th day after transmittal, after which interest will accrue at a rate of six percent per annum. If an issuer has not paid its share of the accounting support fee by the 60th day after a notice was sent, the Board may send a second notice by certified mail. If payment has not been made after the 90th day, the Board may report the issuer's non-payment to the SEC. According to the Adopting Release, failure to pay is a violation of Section 13(b)(2) of the Securities Exchange Act of 1934. In addition, under the final rule no registered public accounting firm may sign an unqualified opinion (or issue a consent) with respect to an issuer's financial statements if that issuer has outstanding any past due share of the accounting support fee.

B. SEC Order Regarding PCAOB Section 101(d) of the Act requires the PCAOB to take such actions as necessary or appropriate to enable the SEC to determine that the Board is organized and has the capacity to carry out the requirements of the Act and enforce compliance by registered public accounting firms. The SEC order indicates that the Commission has determined that the PCAOB has complied with Section 101(d) of the Act. Under the Act, PCAOB's duties include establishment of auditing and other standards relating to public

company audits. Section 103(a)(3)(B) of the Act provides the PCAOB may adopt any portion of existing auditing standards that the Board determines satisfy the requirements of the Act as initial or transitional standards. The Act also provides that any such initial or transitional standards shall be approved by the Commission. The SEC order approves PCAOB's adoption of existing auditing standards as "interim" auditing standards. Gregory M. Smith Director - Operations/Compliance & Fund Accounting

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