

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

Form 19b-4

Proposed Rules

by

Public Company Accounting Oversight Board

In Accordance with Rule 19b-4 under the
Securities Exchange Act of 1934

1. Text of the Proposed Rules

(a) The Public Company Accounting Oversight Board (the “Board” or the “PCAOB”) is filing for the approval of the Securities and Exchange Commission (the “Commission”), pursuant to Section 107 of the Sarbanes-Oxley Act of 2002 (the “Act”), its proposed rules on funding. The text of these rules is attached as Exhibit A.

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Board

(a) The Board approved the proposed rules, and authorized them for filing with the Commission, at its public meeting on April 16, 2003. No other action by the Board is necessary for the filing of these proposed rules.

(b) Questions regarding this filing may be directed to Gordon Seymour, Acting General Counsel (202-207-9034; seymourg@pcaobus.org).

3. Board’s Statement of the Purpose of, and the Statutory Basis for, the Proposed Rules

(a) Purpose

The Act established the Board as a nonprofit corporation, subject to and with all the powers conferred upon a nonprofit corporation by the District of Columbia Nonprofit Corporation Act, to oversee the audits of public companies that are subject to the securities laws, and related matters, in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports for companies the securities of which are sold to, and held by and for, public investors.

Section 109 of the Act provides that funds to cover the Board's annual budget (less registration and annual fees paid by public accounting firms) are to be collected from public companies (i.e., "issuers," as defined in the Act). The amount due from such companies is referred to in the Act as the Board's "accounting support fee." The Board has adopted five proposed rules relating to public company funding of the Board's operations (PCAOB Rules 7100 through 7104), plus certain definitions that would appear in Rule 1001, to implement Section 109 of the Act.

The Board's proposed rules provide for the accounting support fee to be allocated to, and payable by, two classes of issuers: (1) publicly-traded companies with average, monthly U.S. equity market capitalizations during the preceding year, based on all classes of common stock, of greater than \$25 million,^{1/} and (2) investment companies with average, monthly U.S. equity market capitalizations (or net asset values) of greater than \$250 million.^{2/} In recognition of the structure of investment companies and the relatively less-complex nature of investment company audits (as compared to operating company audits), investment companies would be assessed at a lower rate. All other issuers, including (1) those that are not required to file audited

^{1/} The definition of "issuer market capitalization" in Rule 1001(i)(i) defines that term to include only the aggregate market value of securities traded in the United States, whether those securities are issued by entities based in the United States or elsewhere. The definition excludes the market value of securities traded outside the United States.

^{2/} This class would include both registered investment companies and issuers that have elected to be regulated as business development companies pursuant to Section 54 of the Investment Company Act of 1940 ("Investment Company Act"). In the case of an investment company with multiple series, the average, monthly U.S. equity market capitalization, or net asset value, of each series would be measured against the \$250 million threshold separately.

financial statements with the Commission, (2) employee stock purchase, savings and similar plans, and (3) bankrupt issuers that file modified reports, would be allocated shares of zero.^{3/}

(i) Computation of Accounting Support Fee and Allocation to Issuers

Once each year, the Board will compute the accounting support fee.^{4/} The accounting support fee will be equal to the Board's budget for that year, as approved by the Commission, less the amount of registration and annual fees received during the prior year from public accounting firms.^{5/}

In establishing rules on the allocation of the accounting support fee, the Board was guided by two overarching principles that emanate from Section 109 of the Act: that, generally, the accounting support fee must be allocated in a manner that reflects the proportionate sizes of issuers, and that, within that framework, the accounting support fee must be allocated in an equitable manner. These two principles are related in that, at least as a general matter, size of issuer may serve as an indication of the complexity of an audit, which could be an equitable measure on which to base allocation of the accounting support fee.

^{3/} In addition, issuers with average, monthly U.S. equity market capitalizations during the preceding year of less than \$25 million (or, in the case of investment companies, of less than \$250 million), issuers whose only outstanding public securities are debt securities, and issuers whose share price (or net asset value) on a monthly, or more frequent, basis is not publicly available, would be allocated shares of zero.

^{4/} Rule 7100. The Board anticipates that the accounting support fee will normally be computed during the first 30 days of each calendar year.

^{5/} Id. The term "accounting support fee" is defined in Rule 1001(a)(i) by reference to Rule 7100.

With respect to the measurability of issuers' proportionate sizes, the Board faces certain limitations. First, although Section 109 provides a formula based on equity market capitalization by which to measure the proportionate sizes of issuers, market data may not be reliable or even regularly available^{6/} with respect to some issuers, such as issuers that are not traded on an exchange or quoted on Nasdaq, issuers whose securities are otherwise illiquid, and certain investment companies, such as unit investment trusts and insurance company separate accounts. In addition, issuers whose only publicly-traded securities are debt securities do not have equity market capitalizations.

Second, to the extent that there are issuers, as that term is defined in Section 2(a)(7) of the Act, that are not required to file audited financial statements, it may not be equitable to allocate any share of the accounting support fee to them. Further, while most investment companies file annual audited financial statements, the assets of many of those companies consist of investments in issuers who will have themselves been allocated shares of the accounting support fee.

In order to allocate the accounting support fee among issuers in a manner that takes into account the overarching principles and the inherent limitations of available data, the Board's proposed rules divide issuers into four classes:

- (1) All issuers whose average, monthly U.S. equity market capitalization during the preceding calendar year, based on all classes of common stock, is

^{6/} Under Section 109(g), the allocation of an issuer's share of the accounting support fee is to be based on the "average monthly equity market capitalization of the issuer for the 12-month period immediately preceding the beginning of the fiscal year to which" the budget relates.

greater than \$25 million and whose share price on a monthly, or more frequent, basis is publicly available.^{7/} (Equity Issuers 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.^{8/} (Investment Company Issuers class) As discussed below, the allocation formula scales market capitalization (or, for investment companies whose securities are not traded on an exchange or quoted on Nasdaq, net asset value) of investment companies down by 90%, such that a \$250 million investment company would be allocated a share equal to that of a \$25 million operating company.

^{7/} Rule 7101(a). The Commission uses a similar threshold – public float of less than \$25 million – as one of the criteria for determining whether a company qualifies as a small business issuer. See 17 CFR § 228.10.

^{8/} Rule 7101(a)(2). The legislative history of the Act supports the Board’s proposal to establish a separate class for investment company issuers and to allocate shares of the accounting support fee to members of that class at a reduced rate. See Floor Statement of Sen. Enzi, 148 Cong. Rec. S7356 (July 25, 2002):

I also believe that the Conferees expect that the Board and the standard setting body will deem investment companies registered under Section 8 of the Investment Company Act of 1940 to be a class of issuers for purposes of establishing the fees pursuant to this section, and that investment companies as a class will pay a fee rate that is consistent with the reduced risk they pose to investors when compared to an individual company. Audits of investment companies are substantially less complex than audits of corporate entities. The failure to treat investment companies as a separate class of issuers would result in investment companies paying a disproportionate level of fees.

- (3) All issuers that, as of the date the accounting support fee is calculated under Rule 7100, (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, as amended (the “Securities Act”), or (iii) are subject to the jurisdiction of a bankruptcy court and satisfy the modified reporting requirements of Commission Staff Legal Bulletin No. 2^{9/} (Issuers Permitted Not to File Audited Financial Statements and Bankrupt Issuers that File Modified Reports class)
- (4) All other issuers (i.e., issuers that do not fall in classes (1), (2), or (3))^{10/} (All Other Issuers class)

A company’s status as an issuer (or as an investment company, business development company, issuer excused from filing audited financial statements, or bankrupt issuer) 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 that year.

^{9/} Rule 7101(a)(3). Paragraph (i) of this class currently includes (A) asset-backed issuers, (B) unit investment trusts, as defined in Section 4(2) of the Investment Company Act, that have not filed or updated a registration statement that became effective during the preceding year, and (C) Small Business Investment Companies registered on Form N-5 under the Investment Company Act, that have not filed or updated a registration statement that became effective during the preceding year.

^{10/} Rule 7101(a)(4).

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 and Investment Company Issuer classes 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 market capitalization or net asset value.^{11/}
- (2) All issuers in the other two classes – issuers permitted not to file and all other issuers – will be allocated a share of zero.^{12/}

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

(ii) Notice of Allocation and Collection

Section 109 of the Act requires the Board to promulgate rules on assessment and collection of the accounting support fee. Accordingly, the proposed rules provide that, after the annual allocation of the accounting support fee is determined, the Board

^{11/} Rule 7101(b)(1).

^{12/} Rule 7101(b)(2).

will send a notice to each issuer to which a share of the fee has been allocated.^{13/} These notices will be sent either electronically or by first-class mail. Payment will be due on the 30th day after transmittal, after which interest will accrue at a rate of 6% per annum.^{14/}

The Board intends that notices will contain sufficient information to permit issuers to review the calculations by which their allocations were determined. Specifically, all notices will include the amount of the accounting support fee, the date on which the accounting support fee was calculated, the class in which the issuer was placed, the issuer's average, monthly U.S. equity market capitalization for the preceding year, and the sum of the average, monthly U.S. equity market capitalizations of all issuers in the Equity Issuer and Investment Company Issuer classes during the preceding year.^{15/} Issuers that disagree with the class in which they have been placed, or with the calculation by which their allocations were determined, may petition the Board for a correction, in writing.^{16/}

^{13/} Rule 7102. The Board will use its best efforts to send a notice to each issuer. Mailings will be to the address shown on such issuer's most recent periodic report filed with the Commission or submitted to the Commission's EDGAR system, unless the issuer provides another address to the Board. The Board's failure to send an issuer a notice, or the issuer's failure to receive a notice sent by the Board, will not excuse an issuer from its obligation to pay its share of the accounting support fee.

^{14/} Rule 7103(a).

^{15/} As discussed above, the allocation formula will use only 10 percent of the average, monthly market capitalization (or net asset value) of investment companies. Both the market capitalization (or net asset value) and the percentage thereof used in the formula will be disclosed as part of the notice.

^{16/} Rule 7102(c). After the date on which the accounting support fee is calculated under Rule 7100 and allocated under Rule 7101, any change or recalculation of the share allocated to an issuer will not affect the share allocated to any other issuer. Rule 7101(c).

If an issuer has not paid its share of the accounting support fee by the 60th day after a notice was sent, and the issuer does not have a petition pursuant to Rule 7102(c) pending, the Board may send a second notice by certified mail.^{17/} If the Board has sent a second notice and payment has still not been made by the 90th day after the original notice was sent, the Board may report the issuer's non-payment to the Commission.^{18/} An issuer's failure to pay its share of the accounting support fee is a violation of Section 13(b)(2) of the Securities Exchange Act of 1934 ("Exchange Act") and could, like any other Exchange Act violation, result in administrative, civil, or criminal sanctions.^{19/}

In addition, the Board's proposed rules require that no registered public accounting firm may sign an unqualified audit 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 and the issuer has not filed a petition for a correction to its share of the accounting support fee.^{20/} The Board's proposed rules would permit a qualified, adverse or disclaimed opinion irrespective of whether the issuer's share had been paid.^{21/} The collection measures in the Board's proposed rules are intended to

^{17/} Rule 7103(c).

^{18/} Rule 7103(c).

^{19/} See Sections 21C(a), 21(d), and 32(a) of the Exchange Act.

^{20/} Rule 7103(b).

^{21/} Rule 7103(b) does not prevent, in any way, a registered accounting firm from publicly disclosing departures from GAAP, or any other reservations about financial statements, that would be disclosed in a qualified opinion, an adverse opinion, or a disclaimer of an opinion. See AICPA Codification of Statements on Auditing Standards, AU §§ 508.20, 508.58-59, 508.61-62 (AICPA 2002).

ensure the reliability of the independent funding source the Act provides for the Board and to promote fairness to all issuers allocated a share of the accounting support fee. The Board intends the requirement that auditors confirm payment of an issuer's share of the accounting support fee before issuing an unqualified audit opinion to serve as a reliable and cost-effective means of maintaining integrity in the assessment and collection process. A note to proposed Rule 7103(b) explains that a registered public accounting firm may confirm an issuer's payment of the accounting support fee by obtaining a management representation of payment. In addition, the Board plans to build systems that would enable auditors quickly and easily to ascertain whether their issuer audit clients have outstanding any past-due shares of the accounting support fee.

(iii) Collection of Fees for Standard-Setting Body

Under the Act, the standard-setting body designated by the Commission to establish accounting principles is also authorized to collect an accounting support fee from public companies to cover its annual budget.²² The Board's proposed rules recognize that, as contemplated in the Act, the standard-setting body could designate an agent to assess and collect its fees and the Board could be that agent.²³ If that occurs, the Board's assessment and collection of the standard-setting body's fees will be governed by the same rules as apply to the Board's fees.

Consistent with Section 109(e) of the Act, the Board would not be responsible for calculating the standard-setting body's accounting support fee or for allocating its accounting support fee among issuers. While Section 109 of the Act governs both the

^{22/} See Section 109(e) of the Act.

^{23/} Rule 7104.

Board's and the standard-setting body's accounting support fee, the standard-setting body is not required to use the Board's allocation formula. If the standard-setting body designates the Board as its collection agent, however, the Board's proposed rules would effectively require the standard-setting body to agree to the same assessment and collection process (for example, rounding issuers' shares to the nearest hundred, and reporting issuers' non-payment to the Commission) as applies to the Board's accounting support fee. The Board envisions that, if it is designated to serve as the standard-setting body's collection agent, issuers would receive one notice and make one payment. The notice would clearly distinguish between the amount that goes to the Board and the amount that goes to the accounting standard-setter, and it would provide issuers with separate calculations of how the amount of each assessment was reached.

A detailed, section-by-section analysis of the Board's proposed rules on funding follows:

Rule 1001 – Definitions of Terms Employed in Rules

Rule 1001 contains definitions of terms used in the Board's rules.^{24/}

Accounting Support Fee

Rule 1001(a)(i) defines "accounting support fee" as the fee described in Rule 7100 of the Board's proposed rules. As in the Act, the Board's proposed rules use this term to refer to the total amount that issuers are to be assessed to fund the Board's activities, based on the Board's budget, each year.

^{24/} Certain definitions in the Board's rules that are self-explanatory are not discussed below.

Issuer Market Capitalization

Rule 1001(i)(i) defines the term “issuer market capitalization” (and “market capitalization of an issuer”). Paragraph (1) of the definition provides that, for most issuers, the terms mean the aggregate market value of all classes of an issuer’s common stock that trade in the United States. Unless otherwise available, the number of shares issued and outstanding as reported in an issuer’s periodic filings with the Commission will be used to calculate market value. Paragraph (2) of the definition provides that, for an investment company issuer whose securities are not traded on a national securities exchange or quoted on Nasdaq, the terms mean the issuer’s net asset value.

Notice

Rule 1001(n)(i) defines the term “notice” to mean the document sent by the Board to an issuer setting forth the issuer’s share of the accounting support fee.

Rule 7100 – Accounting Support Fee

Rule 7100 provides that the Board shall calculate an accounting support fee each year. Consistent with Section 109(c)(1) of the Act, Rule 7100 further provides that the accounting support fee shall equal the budget of the Board, as approved by the Commission, less the sum of all registration fees and annual fees received during the preceding year from registered public accounting firms.

Rule 7101 – Allocation of Accounting Support Fee

Rule 7101 governs the allocation of the Board's accounting support fee. Consistent with Section 109(d)(2) and (g) of the Act, Rule 7101 differentiates among four classes of issuers for purposes of allocating the Board's accounting support fee. Specifically, Rule 7101(a) divides issuers into four classes:

- (1) All issuers whose average, monthly market capitalization during the preceding calendar year is greater than \$25 million (other than those described in the second and third classes below) and whose share price on a monthly, or more frequent, basis is publicly available;
- (2) All issuers whose average, monthly market capitalization during the preceding calendar year is greater than \$250 million, that, as of the date the accounting support fee is calculated under Rule 7100, are registered under Section 8 of the Investment Company Act or have elected to be regulated as business development companies pursuant to Section 54 of the Investment Company Act (other than those described in the third class below), and whose share price (or net asset value) on a monthly, or more frequent, basis is publicly available;
- (3) All issuers that as of the date the accounting support fee is calculated under Rule 7100, (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 with the Commission, (ii) are employee stock purchase, savings and similar plans, interests in which constitute securities registered under the Securities Act, or (iii) are subject to the jurisdiction of a bankruptcy court and satisfy the modified reporting requirements of Commission Staff Legal Bulletin No. 2; and
- (4) All issuers that do not fall into one of the three classes above.

Notes to this rule explains that average, monthly market capitalization will be based on closing stock prices on the closest trading day on or before the last day of each calendar month measured.

The first class is meant to capture most public operating companies with market capitalizations greater than \$25 million.

The second class of issuers consists of investment companies and business development companies with market capitalizations (or net asset value for those investment companies whose securities are not traded on a national securities exchange or quoted on Nasdaq) of greater than \$250 million. The audits of investment company issuers are typically not as complex as those of operating companies. In addition, these companies are basically vehicles for holding the shares of other companies. Particularly in the case of registered investment companies, those other companies may themselves have already been assessed an accounting support fee. Accordingly, the Board has determined to treat investment companies as a separate class.

The third class consists of issuers that, in general, have a basis not to file audited financial statements with the Commission or to file modified financial statements. A note to this paragraph of the proposed rule explains that the first of the three groups within this class – i.e., those issuers that have a basis not to file audited financial statements – currently would include:

- (1) asset-backed issuers;
- (2) unit investment trusts, as defined in Section 4(2) of the Investment Company Act, that have not filed or updated a registration statement that became effective during the preceding year;
- (3) Small Business Investment Companies registered on Form N-5 under the Investment Company Act, that have not filed or updated a registration statement that became effective during the preceding year;

This note is only meant to illustrate the scope of the first of the three groups within this class, not to limit it. Accordingly, if another group of issuers is permitted, now or in the future, by action of the Commission or its staff, not to file audited financial

statements, that group of issuers would fall within the class, notwithstanding not being listed in the note. Conversely, if the Commission or its staff changed the treatment of one of the groups of issuers listed in the note so as no longer to permit that category of issuers not to file audited financial statements, that category of issuer would no longer fall within the class.

The fourth class of issuers is defined as all issuers not falling within one of the first three classes. The Board anticipates that this class will mainly consist of (i) public companies with average, monthly equity market capitalizations of \$25 million or less during the preceding calendar year, including issuers that have only debt outstanding, (ii) investment companies with average, monthly market capitalizations of \$250 million or less during the preceding calendar year, and (iii) public companies and investment companies for which monthly, or more frequent, market data is not publicly available. Any other issuer that does not fall in one of the other three classes would come within this group, however.

Rule 7101(b) describes what share of the Board's accounting support fee is to be allocated to each of the four classes. Specifically, paragraph (b)(1) of the proposed rule provides that each company in the first two classes 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 U.S. market capitalization during the preceding calendar year. The denominator will be the sum of the average, monthly U.S. market capitalizations of all issuers in the first and second classes. For purposes of this allocation, however, the market capitalization of an investment company issuer will be ten percent of the investment company's average, monthly U.S. equity market

capitalization (or, for investment companies that are not traded on a national securities exchange or quoted on Nasdaq, net asset value). This reduction is meant to reflect that investment company audits are relatively less complex than audits of publicly-traded companies.

Paragraph (2) of the proposed rule provides that all issuers in the third and fourth classes will be allocated a share of zero.

Rule 7101(c) provides that after the accounting support fee is calculated and allocated, any adjustment to the share allocated to an issuer shall not affect the share allocated to any other issuer. This paragraph of the proposed rule is meant to address situations in which an issuer's share is recalculated at some point after the accounting support fee has been calculated and allocated. In these situations, an adjustment to an issuer's share will not result in reallocation of other issuers' shares.

Rule 7102 – Assessment of Accounting Support Fee

Rule 7102 governs the assessment of the Board's accounting support fee. The proposed rule provides that each issuer is required to pay its share of the accounting support fee, as allocated under Rule 7101, rounded to the nearest hundred. Accordingly, issuers whose share of the accounting support fee, is less than \$50 will have their shares rounded to zero and will not be assessed a fee. Rule 7102 also provides that the Board will use its best efforts to send a notice, as defined in Rule 1001(n)(i), to each issuer. Notices will be sent either electronically or by first-class mail to the address shown on such issuer's most recent periodic report filed with the Commission, at the address submitted to the Commission's EDGAR system, or at such

other address as the issuer provides to the Board.^{25/} Rule 7102 also provides that the Board's failure to send an issuer a notice, or the failure of the notice to reach the issuer, shall not constitute a waiver of the Board's right to assess such issuer for its share of the accounting support fee or the issuer's responsibility to pay its share of the accounting support fee. Finally, Rule 7102 also provides for a procedure by which an issuer may petition the Board for a correction to its share of the accounting support fee, on the ground of a mistake in the classification of the issuer or the calculation of the issuer's share.

Rule 7103 – Collection of the Accounting Support Fee

Rule 7103 governs the collection of the Board's accounting support fee. Paragraph (a) of the proposed rule provides that payment of an issuer's share of an accounting support fee shall be due on the 30th day after the notice is sent. The proposed rule also provides that the Board may "direct[] otherwise" to account for unusual situations in which the standard 30-day period is inequitable. The proposed rule also provides that, beginning on the 31st day, interest on the share of the accounting support fee due will accrue at a rate of 6 percent per annum.

Paragraph (b) of the proposed rule contains an additional collection measure. This paragraph of the proposed rule provides that no registered public accounting firm

^{25/} Issuers wishing to provide the Board with an address different than the one that appears on the issuer's most recent periodic Commission filing should send the address to Office of the Secretary, PCAOB, 1666 K Street, N.W., Washington, D.C. 20006-2803. Letters should clearly indicate "Address for Notice of Accounting Support Fee" in the reference line and should include the issuer's full name, preferred address for receiving a notice under this rule, and name and contact information for a person at the issuer to whom questions about the address can be directed.

shall sign an unqualified audit opinion with respect to an issuer's financial statements, or issue a consent to include an audit opinion issued previously, unless the auditor has ascertained that the issuer has outstanding no past-due share of the accounting support fee or has filed a written petition for a correction. A note to this paragraph explains that a registered public accounting firm may ascertain that an issuer has outstanding no past-due share of the accounting support fee by obtaining a representation from the issuer that no past-due share of the accounting support fee is outstanding. The proposed rule permits a qualified, adverse, or disclaimed opinion irrespective of whether the issuer's share had been paid.

Paragraph (c) of the proposed rule provides for a third collection measure. If an issuer has not paid its share of the accounting support fee by the 60th day after a notice was sent, and the issuer does not have a petition pursuant to Rule 7102(c) pending, the Board may send a second notice by certified mail. If the Board has sent a second notice and payment has still not been made by the 90th day after the original notice was sent, the Board may report the issuer's non-payment to the Commission. An issuer's failure to pay its share of the accounting support fee is a violation of Section 13(b)(2) of the Exchange Act and could, like any other Exchange Act violation, result in administrative, civil, or criminal sanctions.^{26/}

Rule 7104 – Service as Designated Collection Agent

Under Section 109(e) of the Act, the standard-setting body designated by the Commission to establish accounting principles is also authorized to collect an

^{26/} See Sections 21C(a), 21(d), and 32(a) of the Exchange Act.

accounting support fee from issuers to cover its annual budget. The Board's proposed rules recognize that, as contemplated in the Act, the standard-setting body may designate a collection agent for its accounting support fee and the Board may be that collection agent. Rule 7104 provides that, if that occurs, the Board's assessment and collection of the standard-setting body's fees will be governed by the same proposed rules as apply to the Board's fees. Consistent with Section 109(e) of the Act, the Board would not be responsible for calculating the standard-setting body's accounting support fee or for allocating its accounting support fee among issuers.

(b) Statutory Basis

The statutory basis for the proposed rules on funding is Title I of the Act.

4. Board's Statement on Burden on Competition

The Board's proposed rules on funding do not impose any undue burden on competition. Pursuant to the statutory formula, issuers will generally pay a fee that is proportionate to the size of their equity market capitalization. In addition, the Board's proposed rules would provide for a fee of zero for issuers with equity market capitalizations of less than \$25 million (or, for investment company issuers, less than \$250 million).

5. Board's Statement on Comments on the Proposed Rules Received from the Public

The proposed rules on funding were published for public comment in PCAOB Release No. 2003-002 (March 14, 2003). A copy of PCAOB Release No 2003-002 is attached as Exhibit 2. Copies of the comment letters received in response to the request for comment are attached as Exhibit 3. The Board received eight written comments, from the following firms and individuals:

- a. Alcon, Inc.
- b. Boeing Company
- c. Deloitte & Touche
- d. Ernst & Young LLP
- e. Henjes, Conner, Williams & Grimsley
- f. Investment Company Institute
- g. KPMG
- h. Paul B.W. Miller, PhD, CPA, University of Colorado at Colorado Springs/Paul R. Bahnson, PhD, CPA, Boise State University

The Board both clarified and modified certain aspects of the proposed rules in response to the comments received. For instance, one commenter requested that the Board clarify how average monthly market capitalization would be determined. The proposed rules and release now explain that average monthly market capitalization will be based on closing prices on the last day of each month measured and, in general, on the number of shares outstanding reported in the issuer's periodic filings with the Commission.

Some commenters also requested that the Board broaden the classes of issuers described as "Equity Issuers" and "Investment Company Issuers," in proposed Rule 7101(a)(1) and (2), to include all public companies and investment companies, regardless of their market capitalizations, and also include issuers with only registered debt securities. Some commenters also suggested establishing a minimum fee for small issuers as an alternative to the formula provided in the Act. The Board's proposal to restrict the Equity Issuers class to issuers whose average monthly market capitalization exceeds \$25 million and to restrict the Investment Company class to issuers whose average monthly market capitalization (or net asset value) exceeds \$250 million was to ensure that the rules can be administered in a reliable and cost-effective manner. As discussed above, reliable market data is difficult to obtain with respect to

issuers that are not traded on an exchange or on Nasdaq, and based on the Board's inquiry, data may not consistently be available with respect to issuers below the proposed rule's thresholds. Based in part on these comments, however, the Board has clarified Rule 7101(a) to more explicitly exclude from those classes issuers whose market capitalization (or net asset value) on a monthly, or more frequent, basis is not publicly available. Also, with respect to issuers of debt securities, Section 109(g) of the Act only provides for the assessment of a share of the accounting support fee based on "equity" market capitalization.

The Board also received a comment suggesting that preferred stock should be included in the definition of issuer market capitalization. The Board proposed that the definition of issuer market capitalization include capitalization of all classes of common stock. After consideration, the Board believes that determining whether each issuer's preferred stock resembles equity or debt would unduly burden the Board's administration of its funding system. Therefore, the Board did not adopt this suggestion.

While one commenter supported the proposed rules with respect to investment companies as proposed, another commenter suggested that the 90 percent reduction in investment company market capitalizations (or net asset values), for purposes of calculating the accounting support fee in proposed Rule 7101(b)(1), was too great a reduction. This commenter did not provide any data to support its position, although it recommended further study of this issue. Based on a comparison of audit fees paid by investment companies to audit fees paid by publicly-traded companies, which was provided by the commenter who supported the Board's proposal, the Board has

determined that assessing investment companies at ten percent of that assessed public companies was appropriate.

In addition, the Board received several comments from accounting firms, suggesting that the Board rely on its referral of delinquent issuers to the Commission instead of require, pursuant to proposed Rule 7103(b), that registered public accounting firms ascertain, before signing an unqualified audit opinion, that issuer audit clients have no outstanding past-due shares of the accounting support fee. While the Board has proposed to refer delinquent issuers to the Commission, the uncertainty, given the Commission's limited resources and other priorities, that the Commission would bring civil actions against such issuers makes a referral alone an unreliable collections mechanism. These commenters also suggested that the Board clarify how this rule would work in practice. In response, the Board has clarified that Rule 7103(b) may be satisfied by obtaining a representation from the issuer that no past due share of the fee is outstanding. The Board has also made clear that an issuer that has filed a written petition for a correction of its share will not be deemed to have a past due share outstanding.

Finally, the Board held two informational meetings during the comment period, one in Washington, DC and one in San Francisco, CA, with representatives of issuers to explain the proposed rules on funding. No substantive comments were received as a result of either meeting.

6. Extension of Time Period for Commission Action

The Board does not consent to an extension of the time period specified in Section 19(b)(2) of the Securities Exchange Act of 1934.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

Not applicable.

8. Proposed Rules Based on Rules of Another Board or of the Commission

The Board's proposed rules on funding are not based on the rules of another board or of the Commission.

9. Exhibits

Exhibit A – Text of the Proposed Rules.

Exhibit 1 – Form of Notice of Proposed Rules for Publication in the *Federal Register*.

Exhibit 2 – PCAOB Release No. 2003-002

Exhibit 3 – Comment Letters

10. Signatures

Pursuant to the requirements of the Act and the Securities Exchange Act of 1934, as amended, the Board has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

Public Company Accounting Oversight Board

BY: _____
Charles D. Niemeier, Acting Chairman

Date: April 17, 2003

Text of the Proposed Rules

Underlining indicates additions; [brackets] indicate deletions

RULES RELATING TO FUNDING

RULES OF THE BOARD

SECTION 1. GENERAL PROVISIONS

1001. Definitions of Terms Employed in Rules.

When used in the Rules, unless the context otherwise requires:

(a)(i) Accounting Support Fee

The term “accounting support fee” means the fee described in Rule 7100.

(i)(i) Issuer Market Capitalization

The terms “issuer market capitalization” and “market capitalization of an issuer” mean –

(1) Except as provided in paragraph (i)(i)(2) of this rule, the aggregate market value of all classes of an issuer’s common stock that trade in the United States; or

(2) With respect to an issuer: (i) that is registered under Section 8 of the Investment Company Act or has elected to be regulated as a business development company pursuant to Section 54 of the Investment Company Act, and (ii) whose securities are not traded on a national securities exchange or quoted on Nasdaq, the issuer’s net asset value.

(i)(ii) Investment Company Act

The term “Investment Company Act” means the Investment Company Act of 1940, as amended.

n)(i) Notice

The term “notice” means the document sent by the Board to an issuer, pursuant to Rule 7102, setting forth such issuer’s share of the accounting support fee under Section 109 of the Act and Rules 7101 and 7102.

(s)(i) Securities Act

The term “Securities Act” means the Securities Act of 1933, as amended.

SECTION 7. FUNDING

RULE 7000.

[reserved]

RULE 7100. Accounting Support Fee.

The Board shall calculate an accounting support fee each year. The accounting support fee shall equal the budget of the Board, as approved by the Commission, less the sum of all registration fees and annual fees received during the preceding calendar year from public accounting firms, pursuant to Section 102(f) of the Act and the Rules of the Board.

RULE 7101. Allocation of Accounting Support Fee.

(a) Classes of Issuers

For purposes of allocating the accounting support fee, those entities that are issuers as of the date the accounting support fee is calculated under Rule 7100 shall be divided into four classes:

(1) Equity Issuers

All issuers whose average, monthly issuer market capitalization during the preceding calendar year is greater than \$25 million, other than those described in paragraphs (a)(2) and (a)(3) of this Rule, and whose share price on a monthly, or more frequent, basis is publicly available.

Note: Average, monthly market capitalization will be based on closing stock prices on the closest trading day on or before the last day of each calendar month measured.

(2) Investment Company Issuers

All issuers (i) who, as of the date the accounting support fee is calculated under Rule 7100, are registered under Section 8 of the Investment Company Act or have elected to be regulated as business development companies pursuant to Section 54 of the Investment Company Act, other than those described in paragraph (a)(3), (ii) whose average, monthly issuer market capitalization during the preceding calendar year is greater than \$250 million, and (iii) whose share price (or net asset value) on a monthly, or more frequent, basis is publicly-available.

Note: Average, monthly market capitalization will be based on closing stock prices on the closest trading day on or before the last day of each calendar month measured.

(3) Issuers Permitted Not to File Audited Financial Statements and Bankrupt Issuers that File Modified Reports

All issuers that, as of the date the accounting support fee is calculated under Rule 7100, (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, or (iii) are subject to the jurisdiction of a bankruptcy court and satisfy the modified reporting requirements of Commission Staff Legal Bulletin No. 2.

Note: As of April 16, 2003, issuers within paragraph (a)(3)(i) of this Rule include (A) asset-backed issuers, (B) unit investment trusts, as defined in Section 4(2) of the Investment Company Act, that have not filed or updated a registration statement that became effective during the preceding year, and (C) Small Business Investment Companies registered on Form N-5 under the Investment Company Act, that have not filed or updated a registration statement that became effective during the preceding year.

(4) All Other Public Company Issuers

All issuers other than those described in paragraphs (a)(1), (a)(2) or (a)(3) of this Rule.

(b) Allocation of Accounting Support Fee Among Issuers

The accounting support fee shall be allocated among the classes in paragraph (a) of this Rule as follows:

(1) Equity and Investment Company Issuers

Each issuer described in paragraph (a)(1) and (a)(2) of this Rule shall be allocated a share of the accounting support fee in an amount equal to the accounting support fee multiplied by a fraction –

- (i) the numerator of which is the average, monthly market capitalization of the issuer during the preceding calendar year, except that for issuers described in paragraph (a)(2) of this Rule, the numerator is one-tenth of the average, monthly market capitalization of the issuer; and
- (ii) the denominator of which is the sum of the average, monthly market capitalizations of the issuers described in paragraph (a)(1) of this Rule and one-tenth of the average, monthly market capitalizations of the issuers described in paragraph (a)(2) of this Rule.

(2) All Other Classes

Each issuer described in paragraphs (a)(3) and (a)(4) of this Rule shall be allocated a share of the accounting support fee equal to \$0.

(c) Adjustments

After the accounting support fee is calculated under Rule 7100 and allocated under this Rule, any adjustment to the share allocated to an issuer shall not affect the share allocated to any other issuer.

RULE 7102. Assessment of Accounting Support Fee.

(a) Amount of Assessment

Each issuer is required to pay its share of the accounting support fee, as allocated under Rule 7101, rounded to the nearest hundred.

Note: If an issuer's share of the accounting support fee is less than \$50, that issuer will not be assessed. If the issuer's share of the accounting support fee is exactly \$50 more than a multiple of \$100, then the share will be rounded up to the nearest \$100.

(b) Notice of Assessment

The Board will use its best efforts to send a notice to each issuer, either electronically or by first-class mail, at the address shown on such issuer's most recent periodic report filed with the Commission, at the address submitted to the Commission's EDGAR system, or at such other address as the issuer provides to the Board. The Board's failure to send an issuer a notice, or the issuer's failure to receive a notice sent

by the Board, shall not constitute a waiver of the Board's right to assess such issuer for its share of the accounting support fee or of the issuer's responsibility to pay its share of the accounting support fee.

(c) Petition for Correction

Any issuer who disagrees with the class in which it has been placed, or with the calculation by which its share of the accounting support fee was determined, may petition the Board for a correction of the share of the accounting support fee it was allocated. Any such petition shall include an explanation of the nature of the claimed mistake in classification or calculation, in writing, on or before the 30th day after the notice is sent. After a review of such a petition, the Board will determine whether the allocation is consistent with Section 109 of the Act and the Board's rules thereunder and provide the issuer a written explanation of its decision. The provisions of Rule 7103 shall be suspended while such a petition is pending before the Board.

RULE 7103. Collection of Accounting Support Fee.

(a) Accounting Support Fee Payment Due Date

Unless the Board directs otherwise, payment shall be due on the 30th day after the notice is sent. Beginning on the 31st day, payment shall be deemed past due and interest shall accrue at a rate of 6 percent per annum.

(b) Confirmation of Payment of Accounting Support Fee by Registered Accounting Firm

No registered public accounting firm shall sign an unqualified audit opinion with respect to an issuer's financial statements, or issue a consent to include an audit opinion issued previously, unless the registered public accounting firm has ascertained that the issuer has outstanding no past-due share of the accounting support fee or has a petition pursuant to Rule 7102(c) pending.

Note: A registered public accounting firm may ascertain that an issuer has no outstanding past-due share of the accounting support fee by obtaining a representation from the issuer or a confirmation from the Board that no past-due share of the accounting support fee is outstanding.

(c) Report to the Commission of Non-payment of an Accounting Support Fee

If an issuer has not paid its share of the accounting support fee by the 60th day after the notice was sent, and the issuer does not have a petition pursuant to Rule 7102(c) pending, the Board may send a second notice to such issuer by certified mail. If the Board has sent such a second notice and has not been paid by the 90th day after the original notice was sent, the Board may report the issuer's nonpayment to the Commission.

Note: Section 13(b)(2) of the Exchange Act provides, in part, that: “Every issuer which has a class of securities registered pursuant to section 12 of this title and every issuer which is required to file reports pursuant to section 15(d) of this title shall – * * * (C) notwithstanding any other provision of law, pay the allocable share of such issuer of a reasonable accounting support fee or fees, determined in accordance with Section 109 of the Sarbanes-Oxley Act of 2002.”

(d) Excess Fees

If in any Board fiscal year, the Board receives fees in excess of the budget for that fiscal year, the Board shall hold those excess fees in escrow. Such escrowed excess fees shall be released to the Board at the beginning of the next fiscal year and shall reduce the Board’s accounting support fee in that next fiscal year.

RULE 7104. Service as Designated Collection Agent

If the Board is designated to serve as collection agent for an accounting support fee of a standard-setting body designated by the Commission pursuant to Section 19(b) of the Securities Act, the assessment and collection of the accounting support fee shall be governed by Rules 7102 and 7103 as if the accounting support fee of the standard-setting body were the accounting support fee of the Board.

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34- ; File No. PCAOB-2003-02)

[Date]

Public Company Accounting Oversight Board, Inc.; Notice of Filing of Proposed Rules
on Funding

Pursuant to Section 107(b) of the Sarbanes-Oxley Act of 2002 (the “Sarbanes-Oxley Act”), notice is hereby given that on April 16, 2003, the Public Company Accounting Oversight Board, Inc. (the “Board” or the “PCAOB”) filed with the Securities and Exchange Commission (the “Commission”) the proposed rules as described in Items I, II, and III below, which items have been prepared by the Board. The Commission is publishing this notice to solicit comments on the proposed rules from interested persons.

I. Board’s Statement of the Terms of Substance of the Proposed Rule Change

On April 16, 2003, the Board adopted five proposed rules relating to public company funding of the Board’s operations (PCAOB Rules 7100 through 7104), plus certain definitions that would appear in PCAOB Rule 1001, to implement Section 109 of the Sarbanes-Oxley Act. Section 109 of the Sarbanes-Oxley Act provides that funds to cover the Board’s annual budget (less registration and annual fees paid by public accounting firms) are to be collected from public companies (i.e., “issuers,” as defined in the Sarbanes-Oxley Act). The amount due from such companies is referred to in the Sarbanes-Oxley Act as the Board’s “accounting support fee.” The five proposed rules

provide for equitable allocation, assessment and collection of the Board's accounting support fee.

II. Board's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Board included statements concerning the purpose of, and basis for, its proposed rules on funding and discussed comments it received on them. The text of these statements may be examined at the places specified in Item IV below. The Board has prepared summaries, set forth in sections A, B and C below, of the most significant aspects of such statements.

A. Board's Statement of the Purpose Of, and Statutory Basis for, the Proposed Rule Change

(a) Purpose

The Act established the Board as a nonprofit corporation, subject to and with all the powers conferred upon a nonprofit corporation by the District of Columbia Nonprofit Corporation Act, to oversee the audits of public companies that are subject to the securities laws, and related matters, in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports for companies the securities of which are sold to, and held by and for, public investors.

Section 109 of the Act provides that funds to cover the Board's annual budget (less registration and annual fees paid by public accounting firms) are to be collected from public companies (i.e., "issuers," as defined in the Act). The amount due from such companies is referred to in the Act as the Board's "accounting support fee." The Board has adopted five proposed rules relating to public company funding of the

Board's operations (PCAOB Rules 7100 through 7104), plus certain definitions that would appear in Rule 1001, to implement Section 109 of the Act.

The Board's proposed rules provide for the accounting support fee to be allocated to, and payable by, two classes of issuers: (1) publicly-traded companies with average, monthly U.S. equity market capitalizations during the preceding year, based on all classes of common stock, of greater than \$25 million,^{1/} and (2) investment companies with average, monthly U.S. equity market capitalizations (or net asset values) of greater than \$250 million.^{2/} In recognition of the structure of investment companies and the relatively less-complex nature of investment company audits (as compared to operating company audits), investment companies would be assessed at a lower rate. All other issuers, including (1) those that are not required to file audited financial statements with the Commission, (2) employee stock purchase, savings and similar plans, and (3) bankrupt issuers that file modified reports, would be allocated shares of zero.^{3/}

^{1/} The definition of "issuer market capitalization" in Rule 1001(i)(i) defines that term to include only the aggregate market value of securities traded in the United States, whether those securities are issued by entities based in the United States or elsewhere. The definition excludes the market value of securities traded outside the United States.

^{2/} This class would include both registered investment companies and issuers that have elected to be regulated as business development companies pursuant to Section 54 of the Investment Company Act of 1940 ("Investment Company Act"). In the case of an investment company with multiple series, the average, monthly U.S. equity market capitalization, or net asset value, of each series would be measured against the \$250 million threshold separately.

^{3/} In addition, issuers with average, monthly U.S. equity market capitalizations during the preceding year of less than \$25 million (or, in the case of investment companies, of less than \$250 million), issuers whose only outstanding public securities are debt securities would be allocated shares of zero, and issuers whose

(i) Computation of Accounting Support Fee and Allocation to Issuers

Once each year, the Board will compute the accounting support fee.^{4/} The accounting support fee will be equal to the Board's budget for that year, as approved by the Commission, less the amount of registration and annual fees received during the prior year from public accounting firms.^{5/}

In establishing rules on the allocation of the accounting support fee, the Board was guided by two overarching principles that emanate from Section 109 of the Act: that, generally, the accounting support fee must be allocated in a manner that reflects the proportionate sizes of issuers, and that, within that framework, the accounting support fee must be allocated in an equitable manner. These two principles are related in that, at least as a general matter, size of issuer may serve as an indication of the complexity of an audit, which could be an equitable measure on which to base allocation of the accounting support fee.

With respect to the measurability of issuers' proportionate sizes, the Board faces certain limitations. First, although Section 109 provides a formula based on equity market capitalization by which to measure the proportionate sizes of issuers, market data may not be reliable or even regularly available^{6/} with respect to some issuers, such

share price (or net asset value) on a monthly, or more frequent, basis is not publicly available.

^{4/} Rule 7100. The Board anticipates that the accounting support fee will normally be computed during the first 30 days of each calendar year.

^{5/} Id. The term "accounting support fee" is defined in Rule 1001(a)(i) by reference to Rule 7100.

^{6/} Under Section 109(g), the allocation of an issuer's share of the accounting support fee is to be based on the "average monthly equity market capitalization of the

as issuers that are not traded on an exchange or quoted on Nasdaq, issuers whose securities are otherwise illiquid, and certain investment companies, such as unit investment trusts and insurance company separate accounts. In addition, issuers whose only publicly-traded securities are debt securities do not have equity market capitalizations.

Second, to the extent that there are issuers, as that term is defined in Section 2(a)(7) of the Act, that are not required to file audited financial statements, it may not be equitable to allocate any share of the accounting support fee to them. Further, while most investment companies file annual audited financial statements, the assets of many of those companies consist of investments in issuers who will have themselves been allocated shares of the accounting support fee.

In order to allocate the accounting support fee among issuers in a manner that takes into account the overarching principles and the inherent limitations of available data, the Board's proposed rules divide issuers into four classes:

- (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.^{7/} (Equity Issuers class)

issuer for the 12-month period immediately preceding the beginning of the fiscal year to which" the budget relates.

^{7/} Rule 7101(a). The Commission uses a similar threshold – public float of less than \$25 million – as one of the criteria for determining whether a company qualifies as a small business issuer. See 17 CFR § 228.10.

- (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.^{8/} (Investment Company Issuers class) As discussed below, the allocation formula scales market capitalization (or, for investment companies whose securities are not traded on an exchange or quoted on Nasdaq, net asset value) of investment companies down by 90%, such that a \$250 million investment company would be allocated a share equal to that of a \$25 million operating company.
- (3) All issuers that, as of the date the accounting support fee is calculated under Rule 7100, (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, as amended (the “Securities Act”), or (iii) are subject to the jurisdiction

^{8/} Rule 7101(a)(2). The legislative history of the Act supports the Board’s proposal to establish a separate class for investment company issuers and to allocate shares of the accounting support fee to members of that class at a reduced rate. See Floor Statement of Sen. Enzi, 148 Cong. Rec. S7356 (July 25, 2002):

I also believe that the Conferees expect that the Board and the standard setting body will deem investment companies registered under Section 8 of the Investment Company Act of 1940 to be a class of issuers for purposes of establishing the fees pursuant to this section, and that investment companies as a class will pay a fee rate that is consistent with the reduced risk they pose to investors when compared to an individual company. Audits of investment companies are substantially less complex than audits of corporate entities. The failure to treat investment companies as a separate class of issuers would result in investment companies paying a disproportionate level of fees.

of a bankruptcy court and satisfy the modified reporting requirements of Commission Staff Legal Bulletin No. 2.^{9/} (Issuers Permitted Not to File Audited Financial Statements and Bankrupt Issuers that File Modified Reports class)

- (4) All other issuers (i.e., issuers that do not fall in classes (1), (2), or (3)).^{10/} (All Other Issuers class)

A company's status as an issuer (or as an investment company, business development company, issuer excused from filing audited financial statements, or bankrupt issuer) 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 that year.

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 and Investment Company Issuer classes 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

^{9/} Rule 7101(a)(3). Paragraph (i) of this class currently includes (A) asset-backed issuers, (B) unit investment trusts, as defined in Section 4(2) of the Investment Company Act, that have not filed or updated a registration statement that became effective during the preceding year, and (C) Small Business Investment Companies registered on Form N-5 under the Investment Company Act, that have not filed or updated a registration statement that became effective during the preceding year.

^{10/} Rule 7101(a)(4).

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 market capitalization or net asset value.¹¹

- (2) All issuers in the other two classes – issuers permitted not to file and all other issuers – will be allocated a share of zero.^{12/}

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.

(ii) Notice of Allocation and Collection

Section 109 of the Act requires the Board to promulgate rules on assessment and collection of the accounting support fee. Accordingly, the proposed rules provide that, after the annual allocation of the accounting support fee is determined, the Board will send a notice to each issuer to which a share of the fee has been allocated.¹³ These notices will be sent either electronically or by first-class mail. Payment will be

^{11/} Rule 7101(b)(1).

^{12/} Rule 7101(b)(2).

^{13/} Rule 7102. The Board will use its best efforts to send a notice to each issuer. Mailings will be to the address shown on such issuer's most recent periodic report filed with the Commission or submitted to the Commission's EDGAR system, unless the issuer provides another address to the Board. The Board's failure to send an issuer a notice, or the issuer's failure to receive a notice sent by the Board, will not excuse an issuer from its obligation to pay its share of the accounting support fee.

due on the 30th day after transmittal, after which interest will accrue at a rate of 6% per annum.^{14/}

The Board intends that notices will contain sufficient information to permit issuers to review the calculations by which their allocations were determined. Specifically, all notices will include the amount of the accounting support fee, the date on which the accounting support fee was calculated, the class in which the issuer was placed, the issuer's average, monthly U.S. equity market capitalization for the preceding year, and the sum of the average, monthly U.S. equity market capitalizations of all issuers in the Equity Issuer and Investment Company Issuer classes during the preceding year.^{15/} Issuers that disagree with the class in which they have been placed, or with the calculation by which their allocations were determined, may petition the Board for a correction, in writing.^{16/}

If an issuer has not paid its share of the accounting support fee by the 60th day after a notice was sent, and the issuer does not have a petition pursuant to Rule 7102(c) pending, the Board may send a second notice by certified mail.^{17/} If the Board has sent a second notice and payment has still not been made by the 90th day after the

^{14/} Rule 7103(a).

^{15/} As discussed above, the allocation formula will use only 10 percent of the average, monthly market capitalization (or net asset value) of investment companies. Both the market capitalization (or net asset value) and the percentage thereof used in the formula will be disclosed as part of the notice.

^{16/} Rule 7102(c). After the date on which the accounting support fee is calculated under Rule 7100 and allocated under Rule 7101, any change or recalculation of the share allocated to an issuer will not affect the share allocated to any other issuer. Rule 7101(c).

^{17/} Rule 7103(c).

original notice was sent, the Board may report the issuer's non-payment to the Commission.^{18/} An issuer's failure to pay its share of the accounting support fee is a violation of Section 13(b)(2) of the Securities Exchange Act of 1934 ("Exchange Act") and could, like any other Exchange Act violation, result in administrative, civil, or criminal sanctions.^{19/}

In addition, the Board's proposed rules require that no registered public accounting firm may sign an unqualified audit 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 and the issuer has not filed a petition for a correction to its share of the accounting support fee.^{20/} The Board's proposed rules would permit a qualified, adverse or disclaimed opinion irrespective of whether the issuer's share had been paid.^{21/} The collection measures in the Board's proposed rules are intended to ensure the reliability of the independent funding source the Act provides for the Board and to promote fairness to all issuers allocated a share of the accounting support fee. The Board intends the requirement that auditors confirm payment of an issuer's share of the accounting support fee before issuing an unqualified audit opinion to serve as a reliable and cost-effective means of maintaining integrity in the assessment and

^{18/} Rule 7103(c).

^{19/} See Sections 21C(a), 21(d), and 32(a) of the Exchange Act.

^{20/} Rule 7103(b).

^{21/} Rule 7103(b) does not prevent, in any way, a registered accounting firm from publicly disclosing departures from GAAP, or any other reservations about financial statements, that would be disclosed in a qualified opinion, an adverse opinion, or a disclaimer of an opinion. See AICPA Codification of Statements on Auditing Standards, AU §§ 508.20, 508.58-59, 508.61-62 (AICPA 2002).

collection process. A note to proposed Rule 7103(b) explains that a registered public accounting firm may confirm an issuer's payment of the accounting support fee by obtaining a management representation of payment. In addition, the Board plans to build systems that would enable auditors quickly and easily to ascertain whether their issuer audit clients have outstanding any past-due shares of the accounting support fee.

(iii) Collection of Fees for Standard-Setting Body

Under the Act, the standard-setting body designated by the Commission to establish accounting principles is also authorized to collect an accounting support fee from public companies to cover its annual budget.^{22/} The Board's proposed rules recognize that, as contemplated in the Act, the standard-setting body could designate an agent to assess and collect its fees and the Board could be that agent.^{23/} If that occurs, the Board's assessment and collection of the standard-setting body's fees will be governed by the same rules as apply to the Board's fees.

Consistent with Section 109(e) of the Act, the Board would not be responsible for calculating the standard-setting body's accounting support fee or for allocating its accounting support fee among issuers. While Section 109 of the Act governs both the Board's and the standard-setting body's accounting support fee, the standard-setting body is not required to use the Board's allocation formula. If the standard-setting body designates the Board as its collection agent, however, the Board's proposed rules would effectively require the standard-setting body to agree to the same assessment and collection process (for example, rounding issuers' shares to the nearest hundred,

^{22/} See Section 109(e) of the Act.

^{23/} Rule 7104.

and reporting issuers' non-payment to the Commission) as applies to the Board's accounting support fee. The Board envisions that, if it is designated to serve as the standard-setting body's collection agent, issuers would receive one notice and make one payment. The notice would clearly distinguish between the amount that goes to the Board and the amount that goes to the accounting standard-setter, and it would provide issuers with separate calculations of how the amount of each assessment was reached.

(b) **Statutory Basis**

The statutory basis for the Board's proposed rules on funding is Title I of the Sarbanes-Oxley Act.

B. **Board's Statement on Burden on Competition**

The Board's proposed rules on funding do not impose any undue burden on competition. Pursuant to the statutory formula, issuers will generally pay a fee that is proportionate to the size of their equity market capitalization. In addition, the Board's proposed rules would provide for a fee of zero for issuers with equity market capitalizations of less than \$25 million (or, for investment company issuers, less than \$250 million).

C. **Board's Statement on Comments on the Proposed Rule Change Received from the Public**

The proposed rules on funding were published for public comment in PCAOB Release No. 2003-002 (March 14, 2003). A copy of PCAOB Release No 2003-002 is attached as Exhibit 2. Copies of the comment letters received in response to the request for comment are attached as Exhibit 3. The Board received eight written comments, from the following firms and individuals:

- a. Alcon, Inc.
- b. Boeing Company
- c. Deloitte & Touche
- d. Ernst & Young LLP
- e. Henjes, Conner, Williams & Grimsley
- f. Investment Company Institute
- g. KPMG
- h. Paul B.W. Miller, PhD, CPA, University of Colorado at Colorado Springs/Paul R. Bahnsen, PhD, CPA, Boise State University

The Board both clarified and modified certain aspects of the proposed rules in response to the comments received. For instance, one commenter requested that the Board clarify how average monthly market capitalization would be determined. The proposed rules and release now explain that average monthly market capitalization will be based on closing prices on the last day of each month measured and, in general, on the number of shares outstanding reported in the issuer's periodic filings with the Commission.

Some commenters also requested that the Board broaden the classes of issuers described as "Equity Issuers" and "Investment Company Issuers," in proposed Rule 7101(a)(1) and (2), to include all public companies and investment companies, regardless of their market capitalizations, and also include issuers with only registered debt securities. Some commenters also suggested establishing a minimum fee for small issuers as an alternative to the formula provided in the Act. The Board's proposal to restrict the Equity Issuers class to issuers whose average monthly market capitalization exceeds \$25 million and to restrict the Investment Company class to issuers whose average monthly market capitalization (or net asset value) exceeds \$250 million was to ensure that the rules can be administered in a reliable and cost-effective manner. As discussed above, reliable market data is difficult to obtain with respect to

issuers that are not traded on an exchange or on Nasdaq, and based on the Board's inquiry, data may not consistently be available with respect to issuers below the proposed rule's thresholds. Based in part on these comments, however, the Board has clarified Rule 7101(a) to more explicitly exclude from those classes issuers whose market capitalization (or net asset value) on a monthly, or more frequent, basis is not publicly available. Also, with respect to issuers of debt securities, Section 109(g) of the Act only provides for the assessment of a share of the accounting support fee based on "equity" market capitalization.

The Board also received a comment suggesting that preferred stock should be included in the definition of issuer market capitalization. The Board proposed that the definition of issuer market capitalization include capitalization of all classes of common stock. After consideration, the Board believes that determining whether each issuer's preferred stock resembles equity or debt would unduly burden the Board's administration of its funding system. Therefore, the Board did not adopt this suggestion.

While one commenter supported the proposed rules with respect to investment companies as proposed, another commenter suggested that the 90 percent reduction in investment company market capitalizations (or net asset values), for purposes of calculating the accounting support fee in proposed Rule 7101(b)(1), was too great a reduction. This commenter did not provide any data to support its position, although it recommended further study of this issue. Based on a comparison of audit fees paid by investment companies to audit fees paid by publicly-traded companies, which was provided by the commenter who supported the Board's proposal, the Board has

determined that assessing investment companies at ten percent of that assessed public companies was appropriate.

In addition, the Board received several comments from accounting firms, suggesting that the Board rely on its referral of delinquent issuers to the Commission instead of require, pursuant to proposed Rule 7103(b), that registered public accounting firms ascertain, before signing an unqualified audit opinion, that issuer audit clients have no outstanding past-due shares of the accounting support fee. While the Board has proposed to refer delinquent issuers to the Commission, the uncertainty, given the Commission's limited resources and other priorities, that the Commission would bring civil actions against such issuers makes a referral alone an unreliable collections mechanism. These commenters also suggested that the Board clarify how this rule would work in practice. In response, the Board has clarified that Rule 7103(b) may be satisfied by obtaining a representation from the issuer that no past due share of the fee is outstanding. The Board has also made clear that an issuer that has filed a written petition for a correction of its share will not be deemed to have a past due share outstanding.

Finally, the Board held two informational meetings during the comment period, one in Washington, DC and one in San Francisco, CA, with representatives of issuers to explain the proposed rules on funding. No substantive comments were received as a result of either meeting.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Board consents the Commission will:

- (a) by order approve the Board's proposed rules on funding; or
- (b) institute proceedings to determine whether the Board's proposed rules on funding should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the requirements of Title I of the Sarbanes-Oxley Act and the Exchange Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609. 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 Room in Washington, D.C. Copies of such filing will also be available for inspection and copying at the principal office of the PCAOB. All

submissions should refer to File No. PCAOB-2003-02 and should be submitted within ___ days.

By the Commission.

Secretary



PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

1666 K Street NW, 9th Floor
Washington, DC 20006
Telephone: (202) 207-9100
Facsimile: (202) 862-8430
www.pcaobus.org

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BOARD FUNDING)
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PROPOSAL FOR ESTABLISHMENT OF)
ACCOUNTING SUPPORT FEE)
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PCAOB Release No. 2003-002
March 14, 2003

PCAOB Rulemaking
Docket
Matter No. 002

Summary: The Public Company Accounting Oversight Board (“Board” or “PCAOB”) has proposed rules to establish the accounting support fee required under the Sarbanes-Oxley Act of 2002 (“Act”) to fund the Board’s activities. The proposed funding system consists of five rules (PCAOB Rules 7100 through 7104), plus certain definitions that would appear in Rule 1001. The Board invites public comment on the proposed rules and will consider all comments received, modify its proposal as it deems appropriate, and submit final rules to the Securities and Exchange Commission (“Commission”) for approval pursuant to Section 107 of the Act. The Board’s proposed funding system rules will not take effect unless and until approved by the Commission.

Public
Comment: Interested persons may submit written comments to the Board. Such comments should be sent to Office of the Secretary, PCAOB, 1666 K Street, N.W., Washington, D.C. 20006-2803. Comments may also be submitted by e-mail to comments@pcaobus.org or through the Board’s website at www.pcaobus.org. All comments should refer to PCAOB Rulemaking Docket Matter No. 002 and should be received by the Board no later than 5:00 PM (EST) on April 4, 2003.

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Board

Contacts: Gordon Seymour, Acting General Counsel (202/207-9034; seymourg@pcaobus.org) or Samantha Ross, Special Counsel to Acting Chairman Niemeier (202/207-9093; ross@s@pcaobus.org).

The Board has proposed, and is seeking comment on, rules relating to public company funding of the Board's operations. Section 109 of the Act provides that funds to cover the Board's annual budget (less registration and annual fees paid by public accounting firms) are to be collected from public companies (i.e., "issuers," as defined in the Act). The amount due from such companies is referred to in the Act as the Board's "accounting support fee."

Under the proposed rules, the accounting support fee would be allocated to, and payable by, two classes of issuers: (1) publicly-traded companies with average, monthly U.S. equity market capitalizations during the preceding year, based on all classes of common stock, of greater than \$25 million,¹ and (2) investment companies with average, monthly U.S. equity market capitalizations (or net asset values) of greater than \$250 million.² In recognition of the structure of investment companies and the relatively less-complex nature of investment company audits (as compared to operating company audits), investment companies would be assessed at a lower rate. All other issuers, including (1) those that are not required to file audited financial statements with the

^{1/} The definition of "issuer market capitalization" in Rule 1001(i)(i) defines that term to include only the aggregate market value of securities traded in the United States, whether those securities are issued by entities based in the United States or elsewhere. The definition excludes the market value of securities traded outside the United States.

^{2/} This class would include both registered investment companies and issuers that have elected to be regulated as business development companies pursuant to Section 54 of the Investment Company Act of 1940 ("Investment Company Act"). In the case of an investment company with multiple series, the average, monthly U.S. equity market capitalization, or net asset value, of all series in the investment company would be aggregated to determine whether the \$250 million threshold has been exceeded.

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Commission, (2) employee stock purchase, savings and similar plans, and (3) bankrupt issuers that file modified reports, would be allocated shares of zero.³

The proposed funding system consists of five rules (PCAOB Rules 7100 through 7104), plus certain definitions that would appear in Rule 1001. Appendices 1 and 2 to this release contain, respectively, the text of these rules and a section-by-section analysis of the rules. Section A of this release provides an overview of the operation of the proposed funding system. Section B of this release requests comments and describes how they may be submitted to the Board.

A. Operation of the Proposed Public Company Funding Rules

1. Computation of Accounting Support Fee and Allocation to Issuers

Once each year, the Board will compute the accounting support fee.⁴ The accounting support fee will be equal to the Board's budget for that year, as approved by the Commission, less the amount of registration and annual fees received during the prior year from public accounting firms.⁵

In allocating the accounting support fee, the Board will be guided by two overarching principles that emanate from Section 109 of the Act: that, generally, the accounting support fee must be allocated in a manner that reflects the proportionate sizes of issuers, and that, within that framework, the accounting support fee must be allocated in an equitable manner. These two principles are related in that, at least as a general matter, size of issuer may serve as an indication of the complexity of an audit,

^{3/} In addition, issuers with average, monthly U.S. equity market capitalizations during the preceding year of less than \$25 million (or, in the case of investment companies, of less than \$250 million), and issuers whose only outstanding public securities are debt securities would be allocated shares of zero.

^{4/} Rule 7100. The Board anticipates that the accounting support fee will normally be computed during the first 30 days of each calendar year.

^{5/} Id. The term "accounting support fee" is defined in Rule 1001(a)(i) by reference to Rule 7100.

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which could be an equitable measure on which to base allocation of the accounting support fee. These proposed rules reflect the Board's preliminary thinking on how best to implement both principles.

With respect to the measurability of issuers' proportionate sizes, the Board faces certain limitations. First, although Section 109 provides a formula based on equity market capitalization by which to measure the proportionate sizes of issuers, market data may not be reliable or even available with respect to issuers that are not traded on an exchange or quoted on Nasdaq, or with respect to issuers whose securities are otherwise illiquid. In addition, issuers whose only publicly-traded securities are debt securities do not have equity market capitalizations.

Second, to the extent that there are issuers, as that term is defined in Section 2(a)(7) of the Act, that are not required to file audited financial statements, it may not be equitable to allocate any share of the accounting support fee to them. Further, while most investment companies file annual audited financial statements, the assets of many of those companies consist of investments in issuers who will have themselves been allocated shares of the accounting support fee.

In order to allocate the accounting support fee among issuers in a manner that takes into account the overarching principles and the inherent limitations of available data, the Board proposes that all issuers be divided into four classes:

- (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.⁶ (Equity Issuers class)

^{6/} Rule 7101(a). The Commission uses a similar threshold – public float of less than \$25 million – as one of the criteria for determining whether a company qualifies as a small business issuer. See 17 CFR § 228.10.

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- (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.⁷ (Investment Company Issuers class)

As discussed below, the allocation formula scales market capitalization (or, for investment companies whose securities are not traded on an exchange or quoted on Nasdaq, net asset value) of investment companies down by 90%, such that a \$250 million investment company would be allocated a share equal to that of a \$25 million operating company.

^{7/} Rule 7101(a)(2). The legislative history of the Act supports the Board's proposal to establish a separate class for investment company issuers and to allocate shares of the accounting support fee to members of that class at a reduced rate. See Floor Statement of Sen. Enzi, 148 Cong. Rec. S7356 (July 25, 2002):

I also believe that the Conferees expect that the Board and the standard setting body will deem investment companies registered under Section 8 of the Investment Company Act of 1940 to be a class of issuers for purposes of establishing the fees pursuant to this section, and that investment companies as a class will pay a fee rate that is consistent with the reduced risk they pose to investors when compared to an individual company. Audits of investment companies are substantially less complex than audits of corporate entities. The failure to treat investment companies as a separate class of issuers would result in investment companies paying a disproportionate level of fees.

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- (3) All issuers that, as of the date the accounting support fee is calculated under Rule 7100, (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, or (iii) are subject to the jurisdiction of a bankruptcy court and satisfy the modified reporting requirements of Commission Staff Legal Bulletin No. 2.⁸ (Issuers Permitted Not to File Audited Financial Statements and Bankrupt Issuers that File Modified Reports class)
- (4) All other issuers (i.e., issuers that do not fall in classes (1), (2), or (3)).⁹ (All Other Issuers class)

A company's status as an issuer (or as an investment company, business development company, issuer excused from filing audited financial statements, or bankrupt issuer) 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 that year.

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 and Investment Company Issuer classes 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,

^{8/} Rule 7101(a)(3). Paragraph (i) of this class currently includes include (A) asset-backed issuers, (B) unit investment trusts, as defined in Section 4(2) of the Investment Company Act, that have not filed or updated a registration statement that became effective during the preceding year, and (C) Small Business Investment Companies registered on Form N-5 under the Investment Company Act, that have not filed or updated a registration statement that became effective during the preceding year.

^{9/} Rule 7101(a)(4).

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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 market capitalization or net asset value.¹⁰

- (2) All issuers in the other two classes – issuers permitted not to file and all other issuers – will be allocated a share of zero.¹¹

Based on equity market capitalizations of U.S. issuers listed in the Wilshire 5000 Index as of December 31, 2002 and other sources,¹² and assuming a total of 7,000 Equity Issuers and Investment Company Issuers, the allocation set forth in the proposed rule would result in Equity Issuers covering approximately 95% percent of the accounting support fee and Investment Company Issuers covering approximately 5% of the accounting support fee. Using these assumptions, the Board's preliminary modeling indicates that, for every \$10 million of accounting support fee, the largest issuer would be allocated \$260,000, the 1,500th largest issuer would be allocated \$500, and the 3,000th largest issuer would be allocated \$100.

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.

^{10/} Rule 7101(b)(1).

^{11/} Rule 7101(b)(2).

^{12/} The sample results discussed here are based on a snapshot of market capitalization on December 31, 2002. Actual average, monthly U.S. equity market capitalization for the year ending December 31, 2002, may be different from these results.

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2. Notice of Allocation and Collection

Section 109 of the Act requires the Board to promulgate rules on assessment and collection of the accounting support fee. Accordingly, the proposed rules provide that, after the annual allocation of the accounting support fee is determined, the Board will send a notice to each issuer to which a share of the fee has been allocated.¹³ These notices will be sent either electronically or by first-class mail. Payment will be due on the 30th day after transmittal, after which interest will accrue at a rate of 6% per annum.¹⁴

The Board intends that notices will contain sufficient information to permit issuers to review the calculations by which their allocations were determined. Specifically, all notices will include the amount of the accounting support fee, the date on which the accounting support fee was calculated, the class in which the issuer was placed, the issuer's average, monthly U.S. equity market capitalization for the preceding year, and the sum of the average, monthly U.S. equity market capitalizations of all issuers in the Equity Issuer and Investment Company Issuer classes during the preceding year.¹⁵ Issuers that disagree with the class in which they have been placed, or with the

^{13/} Rule 7102. The Board will use its best efforts to send a notice to each issuer. Mailings will be to the address shown on such issuer's most recent periodic report filed with the Commission or submitted to the Commission's EDGAR system, unless the issuer provides another address to the Board. The Board's failure to send an issuer a notice, or the issuer's failure to receive a notice sent by the Board, will not excuse an issuer from its obligation to pay its share of the accounting support fee.

^{14/} Rule 7103(a).

^{15/} As discussed above, the allocation formula will use only 10 percent of the average, monthly market capitalization (or net asset value) of investment companies. Both the market capitalization (or net asset value) and the percentage thereof used in the formula will be disclosed as part of the notice.

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calculation by which their allocations were determined, should inform the Board's Secretary, in writing, of the basis for their disagreements.¹⁶

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.¹⁷ If the Board has sent a second notice and payment has still not been made by the 90th day after the original notice was sent, the Board may report the issuer's non-payment to the Commission.¹⁸ An issuer's failure to pay its share of the accounting support fee is a violation of Section 13(b)(2) of the Securities Exchange Act of 1934 ("Exchange Act") and could, like any other Exchange Act violation, result in administrative, civil, or criminal sanctions.¹⁹

In addition, the Board proposes to require that no registered public accounting firm may sign an unqualified audit 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.²⁰ The proposed rules would permit a qualified, adverse or disclaimed opinion irrespective of whether the issuer's share had been paid. The collection measures in the Board's proposed rules are intended to ensure the reliability of the independent funding source the Act provides for the Board and to promote fairness to all issuers allocated a share of the accounting support fee. The Board intends the requirement that auditors confirm payment of an issuer's share of the accounting support fee before issuing an unqualified audit opinion to serve as a reliable and cost-effective means of maintaining integrity in the assessment and collection

^{16/} After the date on which the accounting support fee is calculated under Rule 7100 and allocated under Rule 7101, any change or recalculation of the share allocated to an issuer will not affect the share allocated to any other issuer.

^{17/} Rule 7103(b).

^{18/} Rule 7103(c).

^{19/} See Sections 21C(a), 21(d), and 32(a) of the Exchange Act.

^{20/} Rule 7103(b).

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process. The Board plans to build systems that enable auditors quickly and easily to ascertain whether their issuer audit clients have outstanding any past-due shares of the accounting support fee.

3. Collection of Fees for Standard-Setting Body

Under the Act, the standard-setting body designated by the Commission to establish accounting principles is also authorized to collect an accounting support fee from public companies to cover its annual budget.²¹ The Board's proposed rules recognize that, as contemplated in the Act, the standard-setting body could designate an agent to assess and collect its fees and the Board could be that agent.²² If that occurs, the Board's assessment and collection of the standard-setting body's fees will be governed by the same rules as apply to the Board's fees.

Consistent with Section 109(e) of the Act, the Board would not be responsible for calculating the standard-setting body's accounting support fee or for allocating its accounting support fee among issuers. While Section 109 of the Act governs both the Board's and the standard-setting body's accounting support fee, the standard-setting body is not required to use the Board's allocation formula. If the standard-setting body designates the Board as its collection agent, however, the Board's proposed rules would effectively require the standard-setting body to agree to the same assessment and collection process (for example, rounding issuers' shares to the nearest hundred, and reporting issuers' non-payment to the Commission) as applies to the Board's accounting support fee. The Board envisions that, if it is designated to serve as the standard-setting body's collection agent, issuers would receive one notice and make one payment. The notice would clearly distinguish between the amount that goes to the Board and the amount that goes to the accounting standard-setter, and it would provide issuers with separate calculations of how the amount of each assessment was reached.

^{21/} See Section 109(e) of the Act.

^{22/} Rule 7104.

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B. Request For Public Comment

Interested persons are encouraged to submit their views to the Board. The Board seeks comment on any aspect of these proposed rules. In particular, however, the Board seeks comment on the following questions:

- Is the proposed size of the Equity Issuer class – all publicly-traded companies with average, monthly U.S. equity market capitalizations that exceed \$25 million – appropriate?
- Is the proposed size of the Investment Company Issuer class – all investment companies with average, monthly market capitalizations or net asset values of \$250 million or greater – appropriate?
- Is allocating shares to investment companies based on 10-percent of their average, monthly market capitalization (or net asset value) appropriate?

Written comments should be sent to Office of the Secretary, PCAOB, 1666 K Street, N.W., Washington, D.C. 20006-2803. Comments may also be submitted by e-mail to comments@pcaobus.org or through the Board's website at www.pcaobus.org. All comments should refer to PCAOB Rulemaking Docket Matter No. 002 in the subject or reference line and should be received by the Board no later than 5:00 PM (EST) on April 4, 2003.

The Board will carefully consider all comments received. Following the close of the comment period, the Board will determine whether to amend its proposals, will adopt final public company funding rules, and will submit those rules to the Commission for approval. Pursuant to Section 107 of the Act, Board rules do not take effect until approved by the Commission.

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On the 13th day of March, in the year 2003, the foregoing was, in accordance with the bylaws of the Public Company Accounting Oversight Board,

ISSUED BY THE BOARD.

/s/ Ronald S. Boster

Ronald S. Boster
Acting Secretary

March 13, 2003

APPENDICES:

1. Proposed Rules Relating to Funding
2. Section-by-Section Analysis of Proposed Rules Relating to Funding

Appendix 1 – Proposed Rules Relating to Funding

PROPOSED RULES RELATING TO FUNDING

RULES OF THE BOARD

SECTION 1. GENERAL PROVISIONS

1001. Definitions of Terms Employed in Rules.

When used in the Rules, unless the context otherwise requires:

(a)(i) Accounting Support Fee

The term “accounting support fee” means the fee described in Rule 7100.

(i)(i) Issuer Market Capitalization

The terms “issuer market capitalization” and “market capitalization of an issuer” mean –

- (1) Except as provided in paragraph (i)(i)(2) of this rule, the aggregate market value of all classes of an issuer’s common stock that trade in the United States; or
- (2) With respect to an issuer: (i) that is registered under Section 8 of the Investment Company Act or has elected to be regulated as a business development company pursuant to Section 54 of the Investment Company Act, and (ii) whose securities are not traded on a national securities exchange or quoted on Nasdaq, the issuer’s net asset value.

(i)(ii) Investment Company Act

The term “Investment Company Act” means the Investment Company Act of 1940, as amended.

(n)(i) Notice

The term “notice” means the document sent by the Board to an issuer, pursuant to Rule 7102, setting forth such issuer’s share of the accounting support fee under Section 109 of the Act and Rules 7101 and 7102.

(s)(i) Securities Act

The term “Securities Act” means the Securities Act of 1933, as amended.

SECTION 7. FUNDING

RULE 7000.

[reserved]

RULE 7100. Accounting Support Fee.

The Board shall calculate an accounting support fee each year. The accounting support fee shall equal the budget of the Board, as approved by the Commission, less the sum of all registration fees and annual fees received during the preceding calendar year from public accounting firms, pursuant to Section 102(f) of the Act and the Rules of the Board.

RULE 7101. Allocation of Accounting Support Fee.

(a) Classes of Issuers

For purposes of allocating the accounting support fee, those entities that are issuers as of the date the accounting support fee is calculated under Rule 7100 shall be divided into four classes:

(1) Equity Issuers

All issuers whose average, monthly issuer market capitalization during the preceding calendar year is greater than \$25 million, other than those described in paragraphs (a)(2) and (a)(3) of this Rule.

(2) Investment Company Issuers

All issuers whose average, monthly issuer market capitalization during the preceding calendar year is greater than \$250 million and that, as of the date the accounting support fee is calculated under Rule 7100, are registered under Section 8 of the Investment Company Act or have elected to be regulated as business development companies pursuant to Section 54 of the Investment Company Act, other than those described in paragraph (a)(3).

(3) Issuers Permitted Not to File Audited Financial Statements and Bankrupt Issuers that File Modified Reports

All issuers that, as of the date the accounting support fee is calculated under Rule 7100, (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, or (iii) are subject to the jurisdiction of a bankruptcy court and satisfy the modified reporting requirements of Commission Staff Legal Bulletin No. 2.

Note: As of March 13, 2003, issuers within paragraph (a)(3)(i) of this Rule include (A) asset-backed issuers, (B) unit investment trusts, as defined in Section 4(2) of the Investment Company Act, that have not filed or updated a registration statement that became effective during the preceding year, and (C) Small Business Investment Companies registered on Form N-5 under the Investment Company Act, that have not filed or updated a registration statement that became effective during the preceding year.

(4) All Other Public Company Issuers

All issuers other than those described in paragraphs (a)(1), (a)(2) or (a)(3) of this Rule.

(b) Allocation of Accounting Support Fee Among Issuers

The accounting support fee shall be allocated among the classes in paragraph (a) of this Rule as follows:

(1) Equity and Investment Company Issuers

Each issuer described in paragraph (a)(1) and (a)(2) of this Rule shall be allocated a share of the accounting support fee in an amount equal to the accounting support fee multiplied by a fraction –

- (i) the numerator of which is the average, monthly market capitalization of the issuer during the preceding calendar year, except that for issuers described in paragraph (a)(2) of this Rule, the numerator is one-tenth of the average, monthly market capitalization of the issuer; and
- (ii) the denominator of which is the sum of the average, monthly market capitalizations of the issuers described in paragraph (a)(1) of this Rule and one-tenth of the average, monthly market capitalizations of the issuers described in paragraph (a)(2) of this Rule.

(2) All Other Classes

Each issuer described in paragraphs (a)(3) and (a)(4) of this Rule shall be allocated a share of the accounting support fee equal to \$0.

(c) Adjustments

After the accounting support fee is calculated under Rule 7100 and allocated under this Rule, any adjustment to the share allocated to an issuer shall not affect the share allocated to any other issuer.

RULE 7102. Assessment of Accounting Support Fee.

(a) Amount of Assessment

Each issuer is required to pay its share of the accounting support fee, as allocated under Rule 7101, rounded to the nearest hundred.

Note: If an issuer's share of the accounting support fee is less than \$50, that issuer will not be assessed. If the issuer's share of the accounting support fee is exactly \$50 more than a multiple of \$100, then the share will be rounded up to the nearest \$100.

(b) Notice of Assessment

The Board will use its best efforts to send a notice to each issuer, either electronically or by first-class mail, at the address shown on such issuer's most recent periodic report filed with the Commission, at the address submitted to the Commission's EDGAR system, or at such other address as the issuer provides to the Board. The Board's failure to send an issuer a notice, or the issuer's failure to receive a notice sent by the Board, shall not constitute a waiver of the Board's right to assess such issuer for its share of the accounting support fee or of the issuer's responsibility to pay its share of the accounting support fee.

RULE 7103. Collection of Accounting Support Fee.

(a) Accounting Support Fee Payment Due Date

Unless the Board directs otherwise, payment shall be due on the 30th day after the notice is sent. Beginning on the 31st day, payment shall be deemed past due and interest shall accrue at a rate of 6 percent per annum.

(b) Confirmation of Payment of Accounting Support Fee by Registered Accounting Firm

No registered public accounting firm shall sign an unqualified audit opinion with respect to an issuer's financial statements, or issue a consent to include an audit opinion issued previously, unless the auditor has ascertained that the issuer has outstanding no past-due share of the accounting support fee.

(c) Report to the Commission of Non-payment of an Accounting Support Fee

If an issuer has not paid its share of the accounting support fee by the 60th day after the notice was sent, the Board may send a second notice to such issuer by certified mail. If the Board has sent such a second notice and has not been paid by the 90th day after the original notice was sent, the Board may report the issuer's non-payment to the Commission.

Note: Section 13(b)(2) of the Exchange Act provides, in part, that: "Every issuer which has a class of securities registered pursuant to section 12 of this title and every issuer which is required to file reports pursuant to section 15(d) of this title shall – * * * (C) notwithstanding any other provision of law, pay the allocable share of such issuer of a reasonable accounting support fee or fees, determined in accordance with Section 109 of the Sarbanes-Oxley Act of 2002."

(d) Excess Fees

If in any Board fiscal year, the Board receives fees in excess of the budget for that fiscal year, the Board shall hold those excess fees in escrow. Such escrowed excess fees shall be released to the Board at the beginning of the next fiscal year and shall reduce the Board's accounting support fee in that next fiscal year.

RULE 7104. Service as Designated Collection Agent

If the Board is designated to serve as collection agent for an accounting support fee of a standard-setting body designated by the Commission pursuant to Section 19(b) of the Securities Act, the assessment and collection of the accounting support fee shall be governed by Rules 7102 and 7103 as if the accounting support fee of the standard-setting body were the accounting support fee of the Board.

Appendix 2 – Section-by-Section Analysis of Proposed Rules Relating to Funding

The proposed funding system consists of five rules (PCAOB Rules 7100 through 7104), plus certain definitions that would appear in Rule 1001. Each of the proposed rules is discussed below.

Rule 1001 – Definitions of Terms Employed in Rules

Rule 1001 contains definitions of terms used in the Board's rules.¹

Accounting Support Fee

Rule 1001(a)(i) defines “accounting support fee” as the fee described in Rule 7100 of the Board’s rules. As in the Act, the Board’s rules use this term to refer to the total amount that issuers are to be assessed to fund the Board’s activities, based on the Board’s budget, each year.

Issuer Market Capitalization

Rule 1001(i)(i) defines the term “issuer market capitalization” (and “market capitalization of an issuer”). Paragraph (1) of the definition provides that, for most issuers, the terms mean the aggregate market value of all classes of an issuer’s common stock that trade in the United States. Paragraph (2) of the definition provides that, for an investment company issuer whose securities are not traded on a national securities exchange or quoted on Nasdaq, the terms mean the issuer’s net asset value.

^{1/} Certain definitions in the Board's rules that are self-explanatory are not discussed below.

Notice

Rule 1001(n)(i) defines the term “notice” to mean the document sent by the Board to an issuer setting forth the issuer’s share of the accounting support fee.

Rule 7100 – Accounting Support Fee

Rule 7100 provides that the Board shall calculate an accounting support fee each year. Consistent with Section 109(c)(1) of the Act, Rule 7100 further provides that the accounting support fee shall equal the budget of the Board, as approved by the Commission, less the sum of all registration fees and annual fees received during the preceding year from registered public accounting firms.

Rule 7101 – Allocation of Accounting Support Fee

Rule 7101 governs the allocation of the Board’s accounting support fee. Consistent with Section 109(d)(2) and (g) of the Act, Rule 7101 differentiates between four classes of issuers for purposes of allocating the Board’s accounting support fee. Specifically, Rule 7101(a) divides issuers into four classes:

- (1) All issuers whose average, monthly market capitalization during the preceding calendar year is greater than \$25 million (other than those described in the second and third classes below);
- (2) All issuers whose average, monthly market capitalization during the preceding calendar year is greater than \$250 million and that, as of the date the accounting support fee is calculated under Rule 7100, are registered under Section 8 of the Investment Company Act or have elected to be regulated as business development companies pursuant to Section 54 of the Investment Company Act (other than those described in the third class below);

- (3) All issuers that as of the date the accounting support fee is calculated under Rule 7100, (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 with the Commission, (ii) are employee stock purchase, savings and similar plans, interests in which constitute securities registered under the Securities Act, or (iii) are subject to the jurisdiction of a bankruptcy court and satisfy the modified reporting requirements of Commission Staff Legal Bulletin No. 2; and
- (4) All issuers that do not fall into one of the three classes above.

The first class is meant to capture most public operating companies with market capitalizations greater than \$25 million.

The second class of issuers consists of investment companies and business development companies with market capitalizations (or net asset value for those investment companies whose securities are not traded on a national securities exchange or quoted on Nasdaq) of greater than \$250 million. The audits of investment company issuers are typically not as complex as those of operating companies. In addition, these companies are basically vehicles for holding the shares of other companies. Particularly in the case of registered investment companies, those other companies may themselves have already been assessed an accounting support fee. Accordingly, the Board has determined to treat investment companies as a separate class.

The third class consists of issuers that, in general, have a basis not to file audited financial statements with the Commission or to file modified financial statements. A

note to this paragraph of the rule explains that the first of the three groups within this class – i.e., those issuers that have a basis not to file audited financial statements -- currently would include:

- (1) asset-backed issuers;
- (2) unit investment trusts, as defined in Section 4(2) of the Investment Company Act, that have not filed or updated a registration statement that became effective during the preceding year;
- (3) Small Business Investment Companies registered on Form N-5 under the Investment Company Act, that have not filed or updated a registration statement that became effective during the preceding year;

This note is only meant to illustrate the scope of the first of the three groups within this class, not to limit it. Accordingly, if another group of issuers is permitted, now or in the future, by action of the Commission or its staff, not to file audited financial statements, that group of issuers would fall within the class, notwithstanding not being listed in the note. Conversely, if the Commission or its staff changed the treatment of one of the groups of issuers listed in the note so as no longer to permit that category of issuers not to file audited financial statements, that category of issuer would no longer fall within the class.

The fourth class of issuers is defined as all issuers not falling within one of the first three classes. The Board anticipates that this class will mainly consist of public companies with average, monthly equity market capitalizations of \$25 million or less during the preceding calendar year, including issuers that have only debt outstanding,

and investment companies with average, monthly market capitalizations of \$250 million or less during the preceding calendar year. Any other issuer that does not fall in one of the other three classes would come within this group, however.

Rule 7101(b) describes what share of the Board's accounting support fee is to be allocated to each of the four classes. Specifically, paragraph (b)(1) of the rule provides that each company in the first two classes 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 U.S. market capitalization during the preceding calendar year. The denominator will be the sum of the average, monthly U.S. market capitalizations of all issuers in the first and second classes. For purposes of this allocation, however, the market capitalization of an investment company issuer will be ten percent of the investment company's average, monthly U.S. equity market capitalization (or, for investment companies that are not traded on a national securities exchange or quoted on Nasdaq, net asset value). This reduction is meant to reflect that investment company audits are relatively less complex than audits of publicly-traded companies.

Paragraph (2) of the rule provides that all issuers in the third and fourth classes will be allocated a share of zero.

Rule 7101(c) provides that after the accounting support fee is calculated and allocated, any adjustment to the share allocated to an issuer shall not affect the share

allocated to any other issuer. This paragraph of the rule is meant to address situations in which an issuer's share is recalculated at some point after the accounting support fee has been calculated and allocated. In these situations, an adjustment to an issuer's share will not result in reallocation of other issuers' shares.

Rule 7102 – Assessment of Accounting Support Fee

Rule 7102 governs the assessment of the Board's accounting support fee. The rule provides that each issuer is required to pay its share of the accounting support fee, as allocated under Rule 7101, rounded to the nearest hundred. Accordingly, issuers whose share of the accounting support fee, is less than \$50 will have their shares rounded to zero and will not be assessed a fee. Rule 7102 also provides that the Board will use its best efforts to send a notice, as defined in Rule 1001(n)(i), to each issuer. Notices will be sent either electronically or by first-class mail to the address shown on such issuer's most recent periodic report filed with the Commission, at the address submitted to the Commission's EDGAR system, or at such other address as the issuer provides to the Board.² Rule 7102 also provides that the Board's failure to send an issuer a notice, or the failure of the notice to reach the issuer, shall not constitute a

^{2/} Issuers wishing to provide the Board with an address different than the one that appears on the issuer's most recent periodic Commission filing should send the address to Office of the Secretary, PCAOB, 1666 K Street, N.W., Washington, D.C. 20006-2803. Letters should clearly indicate "Address for Notice of Accounting Support Fee" in the reference line and should include the issuer's full name, preferred address for receiving a notice under this rule, and name and contact information for a person at the issuer to whom questions about the address can be directed.

waiver of the Board's right to assess such issuer for its share of the accounting support fee or the issuer's responsibility to pay its share of the accounting support fee.

Rule 7103 -- Collection of the Accounting Support Fee

Rule 7103 governs the collection of the Board's accounting support fee. Paragraph (a) of the rule provides that payment of an issuer's share of an accounting support fee shall be due on the 30th day after the notice is sent. The rule also provides that the Board may "direct[] otherwise" to account for unusual situations in which the standard 30-day period is inequitable. The rule also provides that, beginning on the 31st day, interest on the share of the accounting support fee due will accrue at a rate of 6 percent per annum.

Paragraph (b) of the rule contains an additional collection measure. This paragraph of the Rule provides that no registered public accounting firm shall sign an unqualified audit opinion with respect to an issuer's financial statements, or issue a consent to include an audit opinion issued previously, unless the auditor has ascertained that the issuer has outstanding no past-due share of the accounting support fee. The proposed rules would permit a qualified, adverse or disclaimed opinion irrespective of whether the issuer's share had been paid.

Paragraph (c) of the Rule provides for a third collection measure. 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 the Board has sent a

second notice and payment has still not been made by the 90th day after the original notice was sent, the Board may report the issuer's non-payment to the Commission. An issuer's failure to pay its share of the accounting support fee is a violation of Section 13(b)(2) of the Exchange Act and could, like any other Exchange Act violation, result in administrative, civil, or criminal sanctions.³

Rule 7104 – Service as Designated Collection Agent

Under Section 109(e) of the Act, the standard-setting body designated by the Commission to establish accounting principles is also authorized to collect an accounting support fee from issuers to cover its annual budget. The Board's proposed rules recognize that, as contemplated in the Act, the standard-setting body may designate a collection agent for its accounting support fee and the Board may be that collection agent. Rule 7104 provides that, if that occurs, the Board's assessment and collection of the standard-setting body's fees will be governed by the same rules as apply to the Board's fees. Consistent with Section 109(e) of the Act, the Board would not be responsible for calculating the standard-setting body's accounting support fee or for allocating its accounting support fee among issuers.

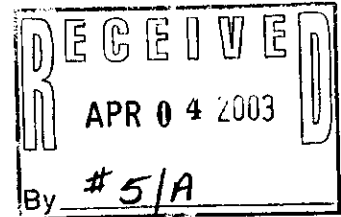
^{3/} See Sections 21C(a), 21(d), and 32(a) of the Exchange Act.



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March 26, 2003

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 20006-2803



PCAOB Rulemaking Docket Matter No. 002

Dear Sir:

Alcon, Inc. appreciates the opportunity to comment on the PCAOB's Rulemaking Docket Matter No. 002, *Proposed Accounting Support Fee*. Since one of the objectives of the PCAOB is to provide confidence in the U.S. investment markets, we agree that the equity market capitalization set forth in the proposed rule should include only those equity securities traded in the United States. We also share the PCAOB's position that the overarching principles for allocating the accounting support fee are:

1. Generally, the accounting support fee must be allocated in a manner that reflects the proportionate sizes of the issuers, and
2. Within that framework, the accounting support fee must be allocated in an equitable manner.

However, we suggest some changes in the methodology of the proposed rule to conform more closely to these principles.

First, we believe the universe of companies bearing the accounting support fee has been too narrowly defined. The proposed rule exempts from the accounting support fee all issuers with less than \$25 million U.S. equity market capitalization, investment companies with less than \$250 million U.S. equity market capitalization, and all issuers whose only publicly traded securities are debt securities.

Equitably, all issuers should bear some proportion of the cost of the PCAOB because their investors also are expected to benefit from the PCAOB's operations. The debt investor is likely to be as concerned with the reliability of financial information as the shareholder is. An issuer that has only registered debt securities does not necessarily present less audit and internal control risk than an issuer with registered equity securities does. The issuers with the proposed exemptions benefit significantly from the registration of the auditing firms, the monitoring of the audit profession and the guidance provided by the standard-setting body. Hence all issuers should bear some proportionate

share of the costs, even if only a flat minimum fee is established as a base rate for all issuers.

Second, we believe that the perceived reduced risk to investors for registered investment companies is not ten times less than compared to other companies. While we may accept that a lesser degree of risk may exist for registered investment companies, the inherent base-levels of audit risk and internal control risk that are present in investment management issuers should not be 10% or less of the average risks in all other issuers. The PCAOB's release presenting the proposed rule offered no empirical studies to support this allocation, which we believe unduly favors registered investment companies. We believe that more study should be performed to more fairly allocate the costs between registered investment companies and other issuers. Why should the reduced rate for investment management companies not be 20%, 25% or even 33%? Based upon the common inherent audit and internal control risks of all issuers, we believe that any of these percentages would be more representative than the currently proposed 10% rate.

Third, we believe the allocation formula should be expanded to include issuers that have only registered debt securities. We do not believe that a privately held issuer with minimal equity and publicly issued debt of \$0.5 billion is considered inherently less risky than an issuer with a \$0.5 billion combination of both registered debt and equity securities. Consequently, both issuers should bear the cost of the PCAOB.

We believe that the numerator and denominator of the allocation fraction should include the outstanding face value of the registered debt securities, in addition to the average, monthly U.S. equity market capitalization. This formula change would permit the accounting support fee to be shared by a larger, more representative universe of issuers, including those with only debt securities.

Fourth, the proposal is not clear about allocations of costs to registered preferred equity securities. Based on past positions of the Securities and Exchange Commission and the wording of the proposed rule, we interpret that preferred equity securities will be treated as debt instruments for purposes of this rule. Issuers of all registered securities who benefit from a confident marketplace should be allocated a portion of the accounting support fee. Therefore, registered preferred equity securities should be included in the allocations based on quoted market prices or, in the absence of quoted market prices, based on their outstanding face values.

.....
Again, we appreciate the opportunity to comment on this proposed rule. If you have any questions concerning our comments, please contact me.

Very truly yours,

Alcon, Inc.



Jeff Stratton

Director, Group Accounting & Reporting

April 4, 2003

Office of the Secretary
PCAOB
1666 K Street, N.W.
Washington, D.C. 20006-2803

Re: Comments on PCAOB Rulemaking Docket Matter No. 002 – Proposal for Establishment of Accounting Support Fee

The undersigned wishes to comment on behalf of The Boeing Company (the “Company”) on the draft release issued by the Public Company Accounting Oversight Board (“PCAOB”) on March 14, 2003, entitled “Proposal for Establishment of Accounting Support Fee” (the “Draft Release”). Comments were specifically requested related to the proposed size and thresholds of the classes of issuers. The Company agrees with the proposed issuer classes, thresholds and allocation procedures as outlined in the Draft Release. We believe that the proposed process for calculating and allocating support fees is the most repeatable and simple process. However, we have the following comments on other aspects of the Draft Release:

- Public accounting firms should not be responsible for enforcing issuers’ payments of accounting support fees.
- The final release should include a description of the PCAOB’s internal procedures to review the budget.
- The final release should explain in more detail how total market capitalization will be calculated.

Enforcement of Accounting Support Fee Payments

The Draft Release requires that no registered public accounting firm may sign an unqualified audit opinion (or issue a consent) with respect to an issuer’s financial statements if that issuer has any past-due accounting support fee. This puts the public accounting firm in the role of payment enforcement. However, there is no direct relationship between a public accounting firm opining on the fair presentation of financial statements and an issuer’s payment of the accounting support fee. Non-payment of similar fees to vendors, suppliers or other parties does not impact the ability to receive an unqualified audit opinion on an issuer’s financial statements. Additionally, there are other areas of non-compliance with rules and regulations (i.e. pending litigation) that do not prohibit an issuer from obtaining an unqualified audit opinion. Therefore, we believe that non-payment of the accounting support fee should not impact whether an issuer can receive an unqualified audit opinion or consent from its independent public accounting firm.

The Draft Release makes it clear that an issuer’s failure to pay its share of the accounting support fee is a violation of the Securities Exchange Act of 1934 and could result in

administrative, civil, or criminal sanctions. Therefore, non-payment of the accounting support fee is directly related to the Securities Exchange Commission (SEC) regulations and should be included in the SEC's scope of enforcement. We believe the SEC, rather than public accounting firms, should have responsibility for enforcing payment of audit support fees.

Internal Review Procedures of PCAOB's Budget

The Draft Release indicates that the PCAOB will compute the accounting support fee based on its annual budget, as approved by the SEC. In addition, Section 109(b) of the Sarbanes-Oxley Act of 2002 indicates that a budget shall be established "which shall be reviewed and approved according to [the PCAOB's] internal procedures." In order to provide appropriate checks and balances of the budget-setting process, we believe that the internal review procedures of the PCAOB should be outlined in the final release. We also suggest that an independent advisory board made up of industry representatives be appointed to perform an additional review of the PCAOB's proposed budget to ensure reasonableness of the total accounting support fee to be allocated to issuers.

Total Market Capitalization Calculation

In calculating the allocation of the accounting support fee, the PCAOB will be required to compute the average monthly market capitalization of each equity and investment company issuer. It is unclear how average monthly market capitalization will be determined. For example, will closing stock prices on the last day of the calendar month be used, or average stock prices? Also, will shares issued and outstanding as reported in each of the issuers' Form 10-Qs be used for each month in that quarter? We believe that the final release should describe in more detail the process for calculating the average monthly market capitalization to be used in the accounting support fee allocation.

* * * * *

We appreciate the opportunity to comment on this topic and your attention to our comments.

Sincerely,

James A. Bell
Senior Vice President Finance and Corporate Controller
The Boeing Company

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April 4, 2003

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 20006-2803

Re: PCAOB Rulemaking Docket Matter No. 002
Proposal For Establishment Of Accounting Support Fee

Deloitte & Touche LLP is pleased to respond to the request for comments from the Public Company Accounting Oversight Board (the "PCAOB" or the "Board") on its *Proposal For Establishment Of Accounting Support Fee*, PCAOB Rulemaking Docket Matter No. 002 (March 14, 2003). We support the goals of the Sarbanes-Oxley Act of 2002 (the "Act") to restore investor confidence, as well as the Board's efforts faithfully to implement the Act.

Introduction

The Act requires that funds to cover the Board's annual budget are to be collected from "issuers."¹ The Board's proposal to implement § 109 of the Act sets forth the manner in which

¹ See Act, § 109; see also Act, § 2(a)(7) (defining "issuer").

these fees from issuers, the “accounting support fees,” are to be calculated and collected.² The Board’s proposal also provides that “no registered public accounting firm may provide an unqualified audit 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.”³

Our comments below relate to that aspect of the Board’s proposal that would forbid a registered accounting firm from signing an unqualified opinion or issuing a consent to include a previously issued audit report, unless the issuer has paid the accounting support fee. This aspect of the proposal raises significant concerns. In summary, we believe (1) this aspect is not necessary given several other provisions in the proposal serve to ensure that issuers will pay the accounting support fees in a timely manner, and (2) this additional mechanism would place an inappropriate and unworkable burden on the registered public accounting firm to police the collection of accounting support fees. We explain these concerns in more detail below.

Other Appropriate Mechanisms Will Help Ensure Payment By Issuers

The release accompanying the Board’s proposal suggests that proposed Rule 7103(b) has been included “to serve as a reliable and cost-effective means of maintaining integrity in the assessment and collection process.”⁴ The proposal, however, already includes several other mechanisms to ensure the reliability and integrity of the assessment and collection process. Specifically, the proposal provides that the Board will send notice to issuers of payments due with respect to the accounting support fee, and issuers will be required to pay the fee within

² PCAOB Proposed Rule 1001(a)(1) (defining “accounting support fee”).

³ PCAOB Release No. 2003-2, at 9.

⁴ *Id.*

thirty days thereafter.⁵ If the issuer has not paid the accounting support fee within sixty days after the notice was sent, the Board can send a second notice demanding payment.⁶ Thereafter, in the event an issuer is more than ninety days past due in paying its accounting support fees, the Board would be able to report the delinquency to the Securities and Exchange Commission (“SEC”), and the failure to pay would be deemed a violation of Section 13(b)(2) of the Exchange Act of 1934 and could result in administrative, civil, or criminal sanctions.⁷

It seems unlikely that an issuer would routinely risk a securities law violation by failing to pay its accounting support fee in a timely fashion. Moreover, if an issuer is more than thirty days past due in paying its accounting support fees, interest will accrue at a rate of 6% per annum.⁸ Thus, the proposal already contains ample incentive for issuers to timely pay their accounting support fees.

The Board Itself Should Monitor The Assessment And Collection Of Fees

The release accompanying the Board’s proposal states that the Board “plans to build systems to enable auditors quickly and easily to ascertain whether their issuer audit clients have outstanding any past-due shares of the accounting support fee.”⁹ With this system in place, the Board itself, rather than registered accounting firms, should use this additional mechanism to monitor assessment and collection of the fee system. Indeed, if the Board develops this system,

⁵ PCAOB Proposed Rule 7103(a).

⁶ PCAOB Proposed Rule 7103(c).

⁷ *Id.*

⁸ PCAOB Proposed Rule 7103(a).

⁹ PCAOB Release No. 2003-2, at 10.

the Board will be in the best position to design and operate the system so that it can oversee assessment and collection of the fee in the most efficient and comprehensive manner. We do not think it would be in the Board's interest to become dependent on the registered accounting firms – the entities they regulate – to help preserve the financial viability of the Board.

As proposed, Rule 7103(b) would obligate the registered accounting firm to “ascertain” that the issuer has no past-due accounting support fees outstanding. Numerous unintended consequences could arise from requiring the registered accounting firm to “ascertain” if the issuer has paid the accounting support fee. As noted above, the Board indicates in its proposal that it plans to establish a system that will disclose whether an issuer has any past due amount with respect to the accounting support fee.¹⁰ Notwithstanding this intent, the text of proposed Rule 7103(b) contains no such reference and in the absence of language in the rule to the contrary or an identifiable system that provides the fee information, a registered accounting firm may feel compelled to perform the necessary calculations and investigate the payment records of the issuer to assure itself that it can issue an unqualified audit opinion or a consent to use a previously issued opinion.

Additionally, during the process, discrepancies could arise between the issuer's and the registered accounting firm's calculation of the fee amount; in these situations, it is unclear whether the registered accounting firm would be able to issue an unqualified opinion or a consent with respect to a previously issued opinion. A registered accounting firm that is being asked to issue a consent with respect to a previously issued opinion also may not be in a position to review an issuer's payment records or perform the necessary calculations if the issuer is no

¹⁰ PCAOB Release No. 2003-2, at 10.

longer an audit client. For these reasons, the Board itself should monitor assessment and collection of the fees without reliance on the registered accounting firms.

Requiring Private Accounting Firms To Enforce A Federal Statute Is Not Appropriate And May Create Additional Risk For Firms

Finally, the accounting support fee is a fee that will be set by an SEC-approved regulation and is imposed by federal statute.¹¹ Accordingly, we believe it is inappropriate to commandeer private accounting firms as agents for the assessment and collection of this federally mandated fee, as contemplated by proposed Rule 7103(b). Unlike private accounting firms, the Board has complete control over the fee system and the information generated thereby, and is charged by statute with the “assessment . . . and collection” of the fee.¹²

We also are concerned that by its terms, the proposed rule would expose registered accounting firms to additional risk. As proposed, Rule 7103(b) would forbid the registered accounting firm to sign an unqualified audit opinion or issue a consent if the issuer has not paid the accounting support fee to the PCAOB. Such a rule poses the threat that issuers may miss critical deadlines related to the issuance of the audit opinion on the financial statements - such as those related to completing vital financing agreements or meeting essential debt covenant requirements. The consequences of forbidding firms from signing unqualified opinions, solely for non-payment to the PCAOB, could be severe for such issuers and may in turn create additional risk for the firms. The non-payment of fees should not impact the type of audit opinion issued on the financial statements or the timing of the issuance of the audit opinion.

¹¹ See Act, § 109(d).

¹² See Act, § 109(d)(2). Indeed, the reference in § 109(d)(2) to “agent[s] appointed by the Board” to collect the fees further suggests that Congress did not intend that accounting firms be entangled in the collection process.

Conclusion

For the reasons discussed above, requiring the accounting firm to police an issuer's payment of the accounting support fee is needlessly duplicative of the proposal's other enforcement mechanisms and will raise needless policy concerns. The Board also states in its release that its rules governing the accounting support fees will be used as the basis for the rules governing fees to be collected by any standard-setting body designated by the Board.¹³ In light of this statement, our concerns are multiplied because the problems identified above could be carried through to fee collection schemes for various standard-setting bodies. We therefore urge the Board to refrain from extending to registered accounting firms any obligation to oversee the collection process for fees established to support any standard-setting body designated by the Board. Accordingly, we recommend that the Board delete in its entirety proposed Rule 7103(b).

* * *

We appreciate the opportunity to comment, and would be pleased to further discuss the Board's proposed rule. If you have any questions or would like to discuss these issues further, please contact Robert J. Kueppers at (203) 761-3579.

Very truly yours,

/s/ Deloitte & Touche LLP

cc: Charles Niemeier, Acting Chairman of the PCAOB
Kayla Gillan, Member
Daniel Goelzer, Member
Willis D. Gradison, Jr., Member

¹³ See PCAOB Release No. 2003-2, at 10.

Ernst & Young LLP

April 4, 2003

Mr. Ronald S. Boster
Acting Secretary
Public Company Accounting Oversight Board
1666 K Street N.W.
Washington, D.C. 20006-2803

PCAOB Rulemaking Docket Matter No. 002, Proposal for Establishment of Accounting Support Fee

Dear Mr. Boster:

Ernst & Young LLP is pleased to comment on the proposed rule to implement public company funding of the operations of the Public Company Accounting Oversight Board (the "Board"), as required by Section 109 of the Sarbanes-Oxley Act of 2002. Our comments are limited to proposed Rule 7103(b), which would require a registered public accounting firm, before issuing an unqualified opinion or its consent to the use of a previously issued opinion, to ascertain that an issuer's assessment of the accounting support fee is not past due.

The Board's proposal states:

"The Board intends the requirement that auditors confirm payment of an issuer's share of the accounting support fee before issuing an unqualified audit opinion to serve as a reliable and cost-effective means of maintaining integrity in the assessment and collection process."

However, the Board's proposal in effect would set a new auditing standard for audits of public companies - a standard that not only is without precedent, but also is one that, as described below, could work against the public interest. There are alternative ways for the Board to effectively achieve its goal of timely collection of fees to support its operations.

Proposed Rule 7103(a) provides that the assessment of the accounting support fee is due on the 30th day after the Board sends the initial assessment notice to the issuer, and that thereafter the fee would be past due with interest. At that time, a registered public accounting firm also would be required to withhold its unqualified opinion or consent under proposed Rule 7103(b), thereby potentially depriving the marketplace of important information about the issuer. Currently, under U.S. generally accepted auditing standards, there are no circumstances in which an auditor would be required to withhold an opinion or consent solely due to an issuer's delinquency in the payment of any taxes, fees, or assessments to governmental agencies or regulatory bodies.¹ We believe that the Board's proposed rule would establish an inappropriate

¹ The only circumstance of which we are aware that would require us to withhold our audit opinion due to a client's non-payment of a fee is where the client has failed to pay us a prior year's audit fee, or other fees for professional services provided more than one year ago. However, the auditor

precedent. In addition, denying issuance of an auditor's opinion or consent is a disproportionate penalty for an unpaid fee – a penalty that would be imposed not only on issuers, but also on investors, creditors, employees and other users of the registrant's financial statements. Without its auditor's opinion or consent, an issuer might become delinquent in its reporting obligations under the Exchange Act, and it would be unable to have a registration statement declared effective under the Securities Act.

The Board's proposal notes that non-payment of the accounting support fee would constitute a violation of Section 13(b)(2) of the Exchange Act, which might subject an issuer to an enforcement action by the SEC. Ultimately, we believe that the consequences of such a violation will serve as a strong incentive to issuers to pay the Board's assessed fees. However, we recommend that the Board work with the Securities and Exchange Commission (the "SEC") to develop sufficient additional incentives for timely payment of the Board's assessments. We note that under proposed Rule 7103(c) the Board may send a notice to the issuer in the event of non-payment 60 days following the Board's transmission of its initial assessment notice. As an additional deterrent to delinquencies, the SEC could require an issuer to publicly disclose, such as in a Form 8-K, its receipt of such a notice from the Board. We believe that the potential public disclosure that its assessment is 30 days past due would be a more appropriate incentive for an issuer to pay the fee than the Board's proposed requirement under Rule 7103(b). Moreover, public disclosure of an issuer's delinquency in paying its assessment would be consistent with the public interest, without causing unnecessary harm to investors and other users of public company financial statements.

* * * * *

We would be pleased to discuss our comments with the Board or its staff at your convenience.

Very truly yours,

/s/ Ernst & Young LLP

independence rules of both the AICPA and SEC impose that restriction out of a concern that such unpaid fees create a direct financial interest in the audit client that would be considered to impair our independence. It is, therefore, a very different requirement from the proposal being made by the Board.

From: Vernon H. Henjes [vhenjes@hwcwg.com]
Sent: Sunday, March 30, 2003 3:20 PM
To: Comments
Subject: Docket No. 002

Gentlemen:

As you know, the Sarbanes-Oxley Act amended several sections of the Securities Exchange Act of 1934 that will require ALL broker/dealers to be audited by a public accounting firm registered with the Public Company Accounting Oversight Board, incurring ongoing costs and potentially burdensome requirements. There are currently 700 accounting firms auditing broker/dealers. It has been estimated that only 50 may opt for PCAOB registration.

We have a broker/dealer client that only has a retail brokerage business with transactions cleared through a national clearing house. The NASD rules would require them (a small company owned only by it's employees) to use a public accounting firm registered with the PCAOB. Since they are not a public company and we are the auditors, I believe there should be no registration fees assessed to small public accounting firms that audit non-publicly owned companies but are required to register with the PCAOB when it was only intended to apply to Public companies and the auditors of public companies. We already have peer review that we have passed without a letter of comment in most years. How many layers of regulation and costs do we need?

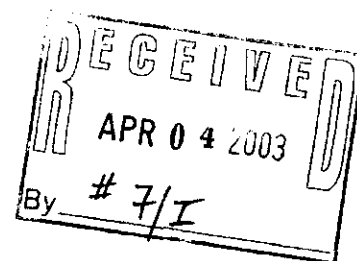
Vernon Henjes, CPA

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712-277-3931-x216
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INVESTMENT COMPANY INSTITUTE

April 4, 2003



Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, NW
Washington, D.C. 20006-2803

Re: Proposal for Establishment of Accounting Support Fee
PCAOB Rulemaking Docket Matter No. 002

Dear Sir or Madam:

The Investment Company Institute¹ appreciates the opportunity to comment on the Public Company Accounting Oversight Board's proposal to establish an annual accounting support fee to cover the funding costs of the Board's operations, as required by Section 109 of the Sarbanes-Oxley Act of 2002.² The Board's proposal specifies the manner in which these funds are to be collected from issuers.

The Institute strongly supports the Board's mission to protect investors by ensuring that an issuer's financial statements are audited according to the highest standards of quality, independence and ethics. In order to fulfill this mandate, it is necessary for the Board to have adequate funding. At the same time, however, it is important that the issuer fees that will be collected to fund the Board are assessed in an equitable manner. The Board's proposal is responsive to this goal, as it would assess investment companies support fees at a lower rate than other issuers, recognizing that audits of investment companies are relatively less complex than audits of other issuers. For this reason, we support the Board's proposal. Our specific comments follow.

Section 109(d) of the Sarbanes-Oxley Act authorizes the Board to establish rules for the equitable allocation, assessment, and collection of fees among issuers, "*allowing for differentiation among classes of issuers, as appropriate.*" To that end, the Board's proposal would allocate the accounting support fee into two classes of issuers: (1) publicly-traded companies with average, monthly U.S. equity market capitalizations during the preceding year, based on all classes of common stock, of greater than \$25 million, and (2) investment companies with average,

¹ The Investment Company Institute is the national association of the American investment company industry. Its membership includes 8,929 open-end investment companies ("mutual funds"), 553 closed-end investment companies and 6 sponsors of unit investment trusts. Its mutual fund members have assets of about \$6.322 trillion, accounting for approximately 95% of total industry assets, and 90.2 million individual shareholders.

² *Board Funding Proposal for Establishment of Accounting Support Fee*, PCAOB Release No. 2003-002 (March 14, 2003) ("Proposing Release"). As the Proposing Release notes, the accounting support fee would be collected in part from public companies, and would consist of funds to cover the Board's annual budget, less registration and annual fees paid by public accounting firms.

monthly U.S. equity market capitalizations (or net asset values) of greater than \$250 million.³ Under the Board's proposal, issuers subject to the fee will be allocated a share of the Board's budget based on their market capitalization (or net assets) relative to total equity market capitalization (including fund net assets). For purposes of this allocation, the market capitalization of an investment company issuer will be ten percent of the investment company's net asset value.⁴

As the Board's proposal points out, this allocation would result in a lower assessment on investment companies, in recognition of the investment company structure and the relatively less-complex nature of investment company audits (as compared to operating company audits).⁵ We strongly agree. As we stated in an earlier letter to the SEC regarding PCAOB funding, a reduced assessment rate for investment companies is entirely appropriate given (1) the relatively simple and straightforward accounting and auditing processes applicable to funds, and (2) the overlay of substantive regulation of funds imposed by the Investment Company Act of 1940, combined with periodic on-site inspection by SEC staff.⁶ For these reasons, basic fairness supports the notion that investment companies should pay a substantially reduced fee rate.⁷

We further believe that the ten percent fee rate under the proposal is an appropriate one. The relative amount of audit fees paid by issuers is an appropriate indicator of the complexity and risk associated with an audit. It also provides a sound basis for estimating the amount of time and resources the Board will likely devote to different classes of issuers. The Institute has compared audit fees paid by investment companies relative to their net assets and audit fees paid by publicly-traded companies relative to their market capitalization.⁸ This comparison revealed that audit fees paid by large investment companies (\$50 billion or more in net assets) amounted to 2.54 percent of those paid by large publicly-traded companies (\$50 billion in market capitalization). Audit fees paid by small investment companies (less than \$100 million in net assets) amounted to 13.45 percent of audit fees paid by small publicly-traded companies (less than \$100 million in market capitalization). Taken together, this indicates that assessing

³ Under the proposal, unit investment trusts that have not filed or updated a registration statement that became effective during the preceding year would pay no fee. We strongly support the proposed treatment of unit investment trusts, which recognizes that the static nature of their portfolios does not raise significant ongoing review by outside auditors and, that, therefore, their investors would realize little if any benefits from support fees in the years following their initial offering.

⁴ Proposed Rule 7101(b)(1).

⁵ See Proposing Release at 2.

⁶ See Letter from Craig S. Tyle, General Counsel, Investment Company Institute, to Jackson M. Day, Acting Chief Accountant, U.S. Securities and Exchange Commission, dated December 20, 2002 ("Institute Letter").

⁷ As the Proposing Release recognizes, this position is consistent with the legislative history on the issue. See Floor Statement of Sen. Enzi, 148 CONG. REC. S7356 (July 25, 2002) (noting that investment companies as a class should pay a lower fee rate that is consistent with the reduced risk they pose to investors when compared to an individual company).

⁸ See Institute Letter, *supra* n. 6.

investment companies at a rate of ten percent of that assessed publicly-traded companies is an appropriate level of assessment.

* * * * *

We appreciate your consideration of our comments. If you have any questions, please contact the undersigned at (202) 326-5851.

Sincerely,



Gregory M. Smith
Director – Operations/
Compliance & Fund Accounting

cc: Charles D. Niemeier, Acting Chairman
Kayla J. Gillan, Board Member
Daniel L. Goelzer, Board Member
William Gradison, Board Member

Public Company Accounting Oversight Board

Jackson M. Day, Acting Chief Accountant

Paul F. Roye, Director
Division of Investment Management

Brian D. Bullard, Chief Accountant
Division of Investment Management

U. S. Securities and Exchange Commission

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 20006-2803

April 4, 2003

Dear Mr. Secretary:

PCAOB Rulemaking Docket Matter No. 002

KPMG appreciates the opportunity to comment on the Public Company Accounting Oversight Board's (Board) proposed rule, *Board Funding: Proposal for Establishment of Accounting Support Fee* (Proposed Rule), which was released March 14, 2003 pursuant to Section 107 of the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley).

The overarching objective of the provisions of Sarbanes-Oxley is one of furthering the public interest through improving financial reporting, governance, and audit quality. KPMG wholeheartedly supports the efforts of the Board in striving to achieve this objective.

KPMG International is a Swiss non-operating association which functions as an umbrella organization to approximately 100 KPMG member firms in countries around the world, to whom it licenses the KPMG name. Each KPMG member firm is autonomous, with its own separate ownership and governance structure. The KPMG member firms do not share profits amongst themselves, and they are not subject to control by any other member firm or by KPMG International.

We set out for your consideration our comments on the Proposed Rule, which reflect the assessment by many of the KPMG member firms who have a direct interest in the new rules because of the number of issuers and affiliates of issuers audited by these firms around the world.

Our comments are limited to the provisions of the Proposed Rule that address the role of the independent auditor in the Board's accounting support fee collection process.

The Proposed Rule would seem to establish a new auditing standard that would prohibit a registered public accounting firm from signing an unqualified audit report or issuing a consent to include an audit report issued previously, "unless the auditor has ascertained that the issuer has outstanding no past-due share of the accounting support fee." We do not see the connection, either to the financial statements or the audit process, between the issuance of an auditors' report or consent and the collection process for the Board's accounting support fees.

Proposed Rule Appendix 2 – *Section by Section Analysis of Proposed Rules Relating to Funding*, acknowledges an issuer's failure to pay its share of the accounting support fee is a violation of Section 13(b)(2) of the Securities Exchange Act of 1934 and could, like

any other Exchange Act violation, result in administrative, civil, or criminal sanctions. The Board's determination that non-payment of accounting support fees violates a law, and the Board's ability to refer the matter to the Commission, would appear to provide issuers with all of the incentive necessary to comply with the accounting support fee requirements.

Accordingly, we believe Rule 7103 (b), *Confirmation of Payment of Accounting Support Fee by Registered Accounting Firm*, should not be included in the final rule because this section in the Proposed Rule does not meet the Board's objective of improving financial reporting, governance, or audit quality.

If the Board concludes that an auditing standard will be developed, it needs to consider among other things the matters set forth in the attached Exhibit.

If you have questions regarding any of the information included in this letter, then please call or write to Neil Lerner + (44) 207 311 8620, neil.lerner@kpmg.co.uk or Michael A. Conway, (212) 909-5555, mconway@kpmg.com.

Yours sincerely,

KPMG

Exhibit

Matters for Consideration in a Proposed Auditing Standard

In its Proposed Rule, the Board has not addressed several questions relative to the registered public accounting firm's requirement to confirm payment of fees with the Board prior to issuing an auditors' report, and, potentially, having to modify the auditors' report for non-payment of such fees. We respectfully request the Board to consider the following before issuance of a proposed rule on a new auditing standard with respect to this matter:

- The proposed auditing standard should clearly articulate why a modification of the auditors' report is required and the nature of the modification (e.g., is it a scope restriction, independence impairment or misapplication of generally accepted accounting principles?).
- In the event the issuer's accounting support fees are past due when an issuer files an annual report with the Commission, is the auditor required to qualify the audit report or is the auditor precluded from issuing its report?
- If it is determined that modification of the auditors' report results in a scope restriction, will the Board modify existing auditing standards dealing with such matters or promulgate a new standard with respect to this scope restriction?
- The Proposed Rule, as written, only addresses unqualified audit reports. Would an additional modification be required if the auditors' report was already qualified, adverse or a disclaimer?
- The Proposed Rule prohibits signing an unqualified auditors' report with respect to an issuer's financial statements in situations where the issuer has past-due accounting support fees.
 - Does this prohibition also apply to the statutory or other reports of foreign private issuers? Application of the Proposed Rule to statutory reports of foreign private issuers may result in an auditors' report modification (for non-payment of accounting support fees) that has no basis in local auditing standards.
 - Does this prohibition apply to the printed annual report of an issuer? Applying the Proposed Rule only to audited financial statements filed with the Commission may result in an unmodified auditors' report in the annual report mailed to shareholders and an auditors' report modification (for non-payment of accounting support fees) on identical financial statements filed with the Commission.
- Article 2 of Regulation S-X (Reg § 210.2-01 (c) and (d)) addresses the opinion to be expressed in auditor's reports, including exceptions taken with respect to certain matters. Has the Board considered if the Commission will accept an auditors' report with a modification for past-due accounting support fees? Has the Board considered whether the Commission will need to issue guidance or amend Regulation S-X with respect to such reporting to conform to the Board's rule?
- If an issuer disagrees with the Board on the amount of assessed fees, will this preclude the auditor from issuing an unqualified auditors' report or consenting to the incorporation of a previously issued auditors' report, thereby restricting access to capi-

tal markets? The same issue may relate to an issuer for whom the Board failed to send an invoice or an invoice was mailed but not received.

Paul B.W. Miller, PhD, CPA Professor of Accounting University of Colorado at Colorado Springs	Paul R. Bahnson, PhD, CPA Associate Professor of Accounting Boise State University
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April 9, 2003

Docket Matter No. 002

Dear Members of the PCAOB and staff:

We are pleased to respond to your proposed rule “Proposal for Establishment of Accounting Support Fee.”

We follow accounting regulation issues closely and often comment on them in our regular column published in *Accounting Today*. We believe that establishing an appropriate funding protocol is crucial to the PCAOB’s long-run ability to function as an effective accounting profession regulator. As a result, we want to share our reservations about the proposed rule.

At the conceptual level, we greatly prefer a system in which at least some of, if not all, the PCAOB’s budget is funded through fees imposed on users and investors rather than auditors and managers. The problem with funding from the traditional sources is that it creates expectations for auditors and managers that as the sole resource providers they should have dominant voices in shaping the board’s policies and decisions. In lieu of the proposed fees, we prefer the levying of a tax on all transactions accomplished on organized stock and bond exchanges. Although the fees on any single transaction would be very small, the cumulative effect would be more than enough to fund the PCAOB. This arrangement would also make it clear to all participants that the boards are not beholden to or dominated by the very parties that they are charged with regulating. From an administrative standpoint, it would be far easier to tax these transactions, which are already carefully recorded and monitored, than to set up a new system to track monthly company market caps and collect fees based on them.

While we believe auditors and managers have no legitimate basis for assuming that the fee should give them control over the board’s processes, everyone knows that similar expectations have haunted FASB. Furthermore, we believe that financial statement users will take a greater interest in the activities of the PCAOB (and FASB, if that board chooses to use the PCAOB to collect its revenue) if they are the funding source.

We recognize that the Sarbanes Oxley Act, as enacted, contemplates funding only by public companies and does not allow for direct investment in the oversight process by investors. Even if the present form of the legislation does not allow a transaction tax, we believe that your discussion of the funding protocol will be enhanced by considering this alternative. As the whole regulatory framework inevitably evolves, perhaps these benefits can be harvested later when the legislation is amended.

As the PCAOB embarks on its mission to regulate the accounting profession, we would also like to point out another general concern about sources of funding. To an extent, it is clear that the PCAOB has used FASB as its model in devising its structure and processes. However, we encourage you to deviate from FASB's practice of charging for its publications. Although dependence on publication sales is misaligned with FASB's fundamental mission, the board relies on this source for more than half of its revenues. In contrast, we think FASB and PCAOB pronouncements should be essentially free for the asking, at least through Internet distribution channels, with pricing for hard copies sufficient only to cover printing and binding costs. Why? Because each board's overriding purpose is to enhance the flow of useful information from corporations to users and investors. We find unacceptable irony in the fact that investors can get annual reports and 10Ks for free but have to pay to get the FASB standards they may need to interpret those documents. We also find it unacceptable that practitioners must incur these costs to inform themselves and their staffs about new developments. Rather than discouraging education, we think the boards should encourage it by distributing their documents freely.

As another argument, we note that existing FASB standards and publications essentially define legal constraints on practice, as will PCAOB releases; therefore, they are public records and, as a matter of policy, should be readily accessible to all interested and affected parties. Perhaps when FASB was created in the days before the Internet, charging for documents was not an issue because people were accustomed to paying for information because it was only available in printed form. Now that documents of all kinds are but a few clicks away, FASB's longstanding practice of selling standards is anachronistic. However, dependence on this revenue stream forces the FAF to cling to its copyrights, and the public either has to buy the documents, pirate them, or go to a library (few of which actually have them). Thus, we urge the PCAOB to distribute its pronouncements without charge over the internet and at only nominal cost for printed versions. We applaud FASB chair Bob Herz for leading the Financial Accounting Foundation to implement a similar plan.

As the PCAOB reviews its proposed corporate funding protocol, we suggest that you consider another change. Specifically, the proposed formula excludes the smallest public companies from any financial responsibility and then imposes a strictly proportional responsibility for companies with market caps that exceed the \$25 million threshold. While there are no doubt greater operational and financial complexities in the largest companies, we doubt that they translate proportionately into greater audit complexity. (For that matter, we are not convinced that audit complexity is the appropriate driver for the fee.) That is, this proposed protocol fails to reflect the fact that the benefits from having the PCAOB in place will accrue to the managers and shareholders of all public companies, including those falling below the threshold. It is our belief that all public companies should share the financial responsibility for supporting the PCAOB.

As an alternative, we propose a structure that imposes a minimum fee on all public companies of some nominal amount, possibly in the range between \$100 and \$1,000 per year. In addition, all companies with market caps in excess of a specified amount (possibly the \$25 million already in place) would be subject to an additional size-based fee, but with a declining rate as the cap goes higher.

We believe this structure offers advantages over the proposal because it would cause all public companies to participate in the PCAOB's operations. Notably, the collective impact of the fees from the smallest companies will diminish any misperception by auditors and managers of large-cap companies that they are empowered by their larger contributions to dominate the PCAOB's agenda and policies.

We recognize that our recommendations go beyond the scope of your call for comments. However, we have raised these fundamental questions because the funding decision is so important.

In closing, we thank you for the opportunity to participate in your decision-making process.

Paul B. W. Miller

Paul R. Bahnson