PCAOB
Public Company Accounting Oversight Board

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BRIEFING PAPER

BOARD FUNDING: ACCOUNTING SUPPORT FEE

April 16, 2003 PUBLIC MEETING OF THE BOARD

At its public meeting on April 16, 2003, the Public Company Accounting Oversight Board (the "Board") will consider whether to adopt, and submit for the approval of the Securities and Exchange Commission (the "Commission"), final rules relating to public company funding of the Board's operations. Section 109 of the Sarbanes-Oxley Act of 2002 (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), including both U.S. companies and foreign private issuers, and investment companies. The amount due from such companies is referred to in the Act as the Board's "accounting support fee." Under the proposed rules, the portion of the accounting support fee allocated to, and payable by, the public companies with market capitalizations of greater than $25 million and registered investment companies with net asset values of greater than $250 million would be determined by a formula based on market capitalization. Investment companies, however, would be treated as a separate class and assessed at a lower rate. All other issuers, including those that are not required to file audited financial statements with the Securities and Exchange Commission ("Commission"), would not be assessed a fee.

The funding system consists of five rules (PCAOB Rules 7100 through 7104), plus definitions. Appended to this paper is a list of the titles of these rules. An overview of the operation of the proposed funding system appears below.

Operation of the Proposed Public Company Funding Rules

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

For purposes of allocating the accounting support fee among public companies, all issuers would be divided into four classes:

(1) Equity Issuers class. The publicly-traded companies with average monthly equity market capitalization, based on all classes of common stock, greater than $25 million during the prior calendar year. Twenty-five million dollars in public float is the threshold under which public companies qualify for the Commission's small business issuer treatment. The Board will obtain market capitalization information from a nationally-recognized market data source.

(2) Investment Company Issuers class. The registered investment companies and issuers that have elected to be regulated as business development companies with average monthly market capitalization or net asset value greater than $250 million during the prior calendar year. The higher threshold for investment companies is appropriate in light of the reduced rate at which they will be assessed, which is discussed below.

(3) Issuers Permitted Not to File class. All issuers that 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 or to file modified financial statements.

(4) All Other Issuers class. Issuers that do not fall in classes (1), (2), or (3).

A company's status as an issuer (or as an investment company, business development company, or issuer excused from filing audited financial statements) 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 Issuers and Investment Company Issuers 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 Equity and Investment Company Issuers.

For purposes of this allocation, however, the market capitalization of an investment company issuer will be ten percent of the investment company's net asset value. This reduction is meant to reflect that investment company audits are relatively less complex than audits of publicly-traded companies.

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

Each year, after the allocation of the accounting support fee is determined, the Board intends to send a notice to each issuer to which a share of the fee has been allocated. Issuers will be assessed for their share of the accounting support fee, rounded to the nearest hundred. If an issuer's share of the accounting support fee is less than $50, that issuer will not be assessed. These bills will be sent either electronically or by first-class mail. Bills will be due on the 30th day after transmittal, after which interest will accrue at a rate equal to 6 percent per annum. If an issuer has not paid its bill by the 60th day, the Board may send a second notice by certified mail. If the bill still remains unpaid after 90 days, 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 Securities Exchange Act of 1934, as amended by Section 109(h) of the Act, and could, like any other Exchange Act violation, result in administrative, civil, or criminal sanctions. In addition, the Board's rules would provide that no registered public accounting firm may sign an unqualified audit opinion with respect to an issuer's financial statements without ascertaining that the issuer has outstanding no past-due share of the accounting support fee. Finally, the Board's rules provide a procedure for an issuer to contest the class in which it was placed or the calculation by which its share was determined.

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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. The Board's rules would 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. If that occurred, the Board's assessment and collection of the standard-setting body's fees would be governed by the same rules as apply to the Board's fees. Responsibility for calculation of the accounting standard-setting body's fees would remain, however, with that body.

Public Comment

Proposed rules on funding were released for public comment on March 14, 2003. The Board received eight written comment letters. The Board's rules would both clarify and modify certain aspects of the proposed rules in response to the comments received. In summary, the revisions to the original proposal would:

- Explain that "average monthly market capitalization" will be based on closing prices on the last day of each month measured and number of shares outstanding will be as reported in the issuer's periodic filings with the Commission;

- Explicitly exclude from the fee allocation issuers whose market capitalization (or net asset value) is not reported on a monthly, or more frequent, basis publicly; and

- Clarify that the auditor's obligation to confirm that its public company client has appropriately paid its fees to the PCAOB may be satisfied by obtaining a representation from the issuer. The Board's rules would also make 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.

Adoption Procedures

If adopted by the Board, the proposed rules will be submitted to the Securities and Exchange 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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PCAOB is a private-sector, non-profit corporation, created by the Sarbanes-Oxley Act of 2002. Its mission is to protect investors in the U.S. markets and to further the public interest by ensuring that public company financial statements are audited according to the highest standards of quality, independence, and ethics. The Board will be principally funded by fees collected from public companies. The costs of processing and reviewing public accounting firm registration applications will be recovered from registration fees paid by those firms.

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APPENDIX

List of Proposed Rules Relating to Funding.

Rule 1001 -- Definition of Terms Employed in Rules

Rule 7100 -- Accounting Support Fee

Rule 7101 -- Allocation of Accounting Support Fee

Rule 7102 -- Assessment of Accounting Support Fee

Rule 7103 -- Collection of the Accounting Support Fee

Rule 7104 -- Service as Designated Collection Agent