

responsibilities to oversee the PCAOB, the Commission has reviewed the budget proposed by the PCAOB for 2003. During the course of that review, among other things, we reviewed and relied upon representations and supporting documentation from the PCAOB. The Commission also has reviewed the aggregate accounting support fee for 2003, which will fund the PCAOB's expenditures. The Commission did not identify any proposed disbursements in the budget that are not properly recoverable through the annual accounting support fee, and the Commission believes that the aggregate proposed 2003 annual accounting support fee does not exceed the PCAOB's aggregate recoverable budget expenses for 2003. After its review, the Commission determined that the PCAOB's 2003 budget and annual accounting support fee are consistent with section 109 of the Act. Accordingly,

*It is ordered*, pursuant to section 109 of the Act, that the PCAOB budget and annual accounting support fee for calendar year 2003 are approved.

By the Commission.

**Margaret H. McFarland,**  
*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-48278; File No. PCAOB-2003-02]

### Public Company Accounting Oversight Board; Order Approving Proposed Rules on Funding and Notice of Filing and Order Granting Accelerated Approval of Amendment No. 1 to the Proposed Rules on Funding

August 1, 2003.

#### I. Introduction

On April 17, 2003, the Public Company Accounting Oversight Board ("Board" or "PCAOB") filed with the Securities and Exchange Commission ("Commission") proposed rules PCAOB-2003-02 pursuant to sections 107 and 109 of the Sarbanes-Oxley Act of 2002 ("Act"). Notice of the proposed rules was published in the **Federal Register** on June 27, 2003.<sup>1</sup> The Commission received five comment letters. For the reasons discussed below, the Commission is granting approval of the proposed rules.

On July 30, 2003, the PCAOB adopted Amendment No. 1 to its proposed rules and submitted that amendment to the Commission.<sup>2</sup> We find there is good cause to approve this amendment prior to the thirtieth day after publication in the **Federal Register** and, for the reasons discussed below, we are approving the amendment.

#### II. Description

In accordance with the Act,<sup>3</sup> the PCAOB has adopted proposed rules<sup>4</sup> that would establish a mechanism to fund the operations of the PCAOB with an annual accounting support fee to be collected from issuers.<sup>5</sup> Under sections 107 and 109 of the Act, such rules are subject to the approval of the Commission. In addition, section 109(h) of the Act amends Section 13(b)(2) of the Securities Exchange Act of 1934 ("Exchange Act") to require issuers to pay the allocable share of a reasonable annual accounting support fee or fees, determined in accordance with Section 109 of the Act.

The following is a brief summary of certain key provisions contained in the proposed funding rules.

Proposed PCAOB Rule 7100 provides, among other things, that the annual accounting support fee shall equal the approved budget of the Board, less the sum of all registration fees and annual fees collected during the preceding year from registered public accounting firms.

Proposed PCAOB Rule 7101 provides for the accounting support fee to be allocated to four classes of issuers, two of which are: (1) Publicly-traded companies with average, monthly U.S. equity market capitalizations<sup>6</sup> during the preceding year, based on all classes of common stock, of greater than \$25 million, and (2) investment companies with average, monthly U.S. equity market capitalizations (or net asset

values) of greater than \$250 million.<sup>7</sup> 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 than operating companies. Other classes of issuers would be allocated shares of zero.<sup>8</sup>

Proposed PCAOB Rule 7102 governs the assessment of the Board's accounting support fee. Shares of the accounting support fee would be rounded to the nearest \$100.

Proposed PCAOB Rule 7103 governs the collection of the accounting support fee. The fee would be due 30 days after notice is sent. Interest would accrue at 6 percent per annum commencing on the 31st day after the notice is sent. The proposed rule also provides that no registered public accounting firm may sign an unqualified opinion<sup>9</sup> 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 no past due fees payable to the Board.<sup>10</sup> In addition, the Commission notes that failure to pay the accounting support fee would be a violation of section 13(b)(2)(C) of the Exchange Act.

Proposed PCAOB Rule 7104 provides that if the accounting standard setting body recognized by the Commission under Section 108(b)(1)(B) of the Act<sup>11</sup>

<sup>7</sup> 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 of funds, the average, monthly U.S. equity market capitalization, or net asset value, of each series would be measured against the \$250 million threshold separately.

<sup>8</sup> For example, an issuer would be allocated a share of zero if: its average, monthly U.S. equity market capitalization during the preceding year is less than \$25 million (or, in the case of investment companies, of less than \$250 million), its only outstanding public securities are debt securities, or its share price (or net asset value) on a monthly, or more frequent, basis is not publicly available. Other issuers that would be allocated shares of zero include: (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.

<sup>9</sup> "An unqualified opinion states that the financial statements present fairly, in all material respects, the financial position, results of operations, and cash flows of the entity in conformity with generally accepted accounting principles." AICPA, Statements on Auditing Standards ("SAS") No. 58, Codification of Statements on Auditing Standards ("AU") 508.10.

<sup>10</sup> See Accelerated Approval of Amendment No. 1, *infra*.

<sup>11</sup> The Commission has designated the Financial Accounting Standards Board ("FASB") as an

Continued

<sup>1</sup> Securities Exchange Act Release No. 48075 (June 23, 2003); 68 FR 38406 (June 27, 2003).

<sup>2</sup> Amendment No. 1 was delivered to the Commission's Office of the Secretary on July 30, 2003.

<sup>3</sup> See, e.g., Section 109(d) of the Act.

<sup>4</sup> PCAOB Rules 7100 through 7104.

<sup>5</sup> The term "issuer" is defined in section 2(a)(7) of the Act to mean "an issuer (as defined in section 3 of the Securities Exchange Act of 1934 (15 U.S.C. 78(c)), the securities of which are registered under section 12 of that Act (15 U.S.C. 78l), or that is required to file reports under section 15(d) (15 U.S.C. 78o(d)), or that files or has filed a registration statement that has not yet become effective under the Securities Act of 1933 (15 U.S.C. 77a *et seq.*), and that it has not withdrawn."

<sup>6</sup> Rule 1001(i)(i) defines "issuer market capitalization" 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.

designates the PCAOB as the collection agent for that body's support fee then the PCAOB's collection and assessment rules (PCAOB proposed rules 7102 and 7103) would apply to that accounting standard setting body's support fee. Proposed rule 7104 states that the PCAOB, however, would not be responsible for calculating the standard setting body's support fee or the allocation of such fee among issuers.

### III. Discussion of Comment Letters

The Commission received five comment letters regarding the PCAOB's proposed rules on the support fee. One letter was from the Investment Company Institute, one letter was from a financial services company,<sup>12</sup> one was from the Federation of German Industries, and two letters were from accounting firms.<sup>13</sup>

The Investment Company Institute ("ICI") expressed concern that the funding rules would cause issuers of variable insurance contracts to pay twice the amount of support fees charged to other types of investment companies. Variable contracts are typically issued by an investment company that invests its assets in one or more other underlying investment companies, and the ICI noted that, under the proposed rules, both the variable contract issuer and the underlying investment company would pay a support fee.<sup>14</sup> While we appreciate the ICI's concerns, we note that the financial statements of both investment companies must be audited, and that the PCAOB would oversee both audits. Further, we note that under the proposed rules investment companies already are assessed at a lower rate than other issuers. Accordingly, we believe that the PCAOB rule is reasonable in this regard.

The ICI also requests additional advice on how the rules apply to "master-feeder fund arrangements" where feeder funds sell shares to the

public and then use the proceeds to purchase shares of a master fund, which are offered in private placements. We encourage the PCAOB to consider whether additional guidance is appropriate.

The Federation of German Industries noted, among other things, that many foreign private issuers are not required to disclose the number of shares outstanding in the United States in their periodic reports filed with the Commission but that such information should be available from applicable stock exchanges in the United States.<sup>15</sup>

The comment letters from the accounting firms noted concerns and requested guidance regarding, among other things, PCAOB proposed rule 7103(b), which provides that auditors may not sign an unqualified audit opinion with respect to an issuer's financial statements, or issue a consent to the use of a previously issued audit opinion, unless the registered public accounting firm has ascertained that the issuer either has no outstanding past-due share of the accounting support fee or has a pending petition for correction of the fee.

One accounting firm also indicated that proposed rule 7103(b) was unnecessary given other incentives on issuers to pay the fee, was counter to the policy of encouraging the issuance of timely audit reports, was inappropriate in that the PCAOB was in a better position than the auditor to ascertain if payment had been made, and placed an inappropriate burden on auditors.<sup>16</sup> We observe, however, that a Note to proposed rule 7103 states that auditors may ascertain that no past-due fee is outstanding by obtaining a representation from the issuer or a confirmation from the PCAOB. Auditors routinely obtain representations from management and seek confirmations from outside sources as part of their audit processes. Further, because the limitation in proposed rule 7103 pertains only to the issuance of unqualified audit opinions and consents, the rule would not prevent an auditor from signing a qualified or adverse audit opinion regardless of whether the issuer has paid its portion of the support fee.<sup>17</sup> As discussed

below, the PCAOB has adopted an amendment to this provision.

### IV. Accelerated Approval of Amendment No. 1; Solicitation of Comments

Amendment No. 1 to the proposed rule change would provide that the auditor of an issuer's financial statements may sign an unqualified audit opinion with respect to the issuer's financial statements, or issue a consent to the use of previously issued auditor opinions, even if the issuer has outstanding a past-due share of the accounting support fee and has not filed a petition for correction of that fee, if the issuer needs the auditor opinion or consent in order to submit a report to, or make a filing with, the Commission. Under the amendment, the issuer would submit to the PCAOB a notice of the signing of the audit opinion or issuance of the consent not later than one business day after the related filing is made with the Commission. This exception would not continue longer than 15 business days after the earlier of the submission of the notice to the PCAOB or the filing of the report or registration statement with the Commission, and may not be invoked for more than one such 15-business day period with respect to any share of the accounting support fee that the issuer is assessed under rule 7102.

We find good cause to approve Amendment No. 1 to the proposed rule prior to the thirtieth day after the date of publication of notice of filing Amendment No. 1 in the **Federal Register**. The original proposed rules, as noted above, were published in the **Federal Register**. We believe that Amendment No. 1 refines the rules and facilitates capital formation by assuring that an issuer, due to the inability to obtain an unqualified audit report or auditor consent, would not be denied access to the capital markets due to an inadvertent issue with respect to payment of the support fee. Amendment No. 1 also clarifies the obligations of auditors when an issuer or the auditor, upon the eve of a report or registration statement being filed with the Commission, becomes aware that the issuer has not paid or sought correction of a support fee. Amendment No. 1 does not contain major modifications from the scope and purpose of the rules as originally proposed, and was developed from the original proposal. We believe, moreover, that approving Amendment No. 1 will provide greater clarity and facilitate capital formation, thus furthering the public interest and the investor protection goals of the Act and of the securities laws. Finally, we also

accounting standard setting body under section 108. See Financial Reporting Release No. 70 (April 25, 2003) (68 FR 23333 (May 1, 2003)). The Financial Accounting Foundation ("FAF"), which is the board of trustees that provides administrative and operational functions for the FASB in accordance with section 19(b)(1)(A)(ii) of the Securities Act of 1933, 15 U.S.C. 77s(b)(1)(A)(ii), has informed the Commission that it intends to appoint the PCAOB as its collection agent and to utilize the formula in PCAOB rule 7101 as the allocation to be used for the FASB support fee. See letter dated June 11, 2003 from Joseph S. LaGambina, Executive Vice President, FAF, addressed to Mr. Scott Taub, Deputy Chief Accountant.

<sup>12</sup> Letter from Nationwide Financial Services, Inc.

<sup>13</sup> See letters from KPMG LLP and Deloitte & Touche LLP.

<sup>14</sup> Nationwide Financial Services, Inc., expressed similar concerns.

<sup>15</sup> The number of shares traded in the United States is a necessary component of the fee calculation under the PCAOB's proposed rules. See PCAOB rules 1001(i)(i) and 7101.

<sup>16</sup> Letter from Deloitte & Touche LLP.

<sup>17</sup> Under the PCAOB's proposed rules, an issuer may not delay publication of a qualified or adverse audit report simply by not paying its portion of the support fee.

find that it is in the public interest to approve the rules as soon as possible to expedite the implementation of the proposed rules.

Accordingly, we believe good cause exists, consistent with sections 107 and 109 of the Act, and Section 19(b) of the Exchange Act, to approve Amendment No. 1 to the proposed rules on an accelerated basis.

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 1, including whether the amendments are consistent with the Act and the securities laws or are necessary or appropriate in the public interest or for the protection of investors. 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 amendments that are filed with the Commission, and all written communications relating to the amendments 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 at the Commission's Public Reference Room.

All submissions should refer to File No. PCAOB-2003-02 and should be submitted by September 8, 2003.

## V. Conclusion

Title I of the Act assigns to the PCAOB the task of designing and implementing registration, standard-setting, inspection, and disciplinary systems that promote the preparation of accurate, informative and independent audit reports. To fulfill these functions, the PCAOB must have a reliable source of funds and rules that provide for the allocation, assessment, and collection of fees in an equitable manner in accordance with section 109(d) of the Act.

Congress, in enacting section 109, required that the recoverable budget expenses of the PCAOB and the

accounting standard setting body be payable through accounting support fees assessed on issuers. Congress also set forth the basic formula for calculating the support fees based on issuers' relative market capitalizations.

The PCAOB is charged under section 109 to adopt rules, subject to the Commission's approval, that establish a reasonable annual accounting support fee (or a formula for the computation thereof) as may be necessary or appropriate to establish and maintain the Board, and provide for the equitable allocation and assessment of the support fees among, and collection of the support fees from, issuers. Section 109 directs the PCAOB to allow for differentiation of the fees among classes of issuers, as appropriate.

On the basis of the foregoing, the Commission finds that the proposed rules, as amended, are consistent with the requirements of the Act and the securities laws and are necessary and appropriate in the public interest and for the protection of investors.

*It is therefore ordered*, pursuant to sections 107 and 109 of the Act, and section 19(b)(2) of the Exchange Act, that the proposed rules (File No. PCAOB-2003-02), as amended, be and hereby are approved.

By the Commission.

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-48271; File No. SR-BSE-2003-13]

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Boston Stock Exchange, Inc. Relating to the Initial Allocation Plan for the Proposed Boston Options Exchange Facility

August 1, 2003.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934

("Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on July 30, 2003, the Boston Stock Exchange, Inc. ("BSE" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

### I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The BSE proposes to add new Chapter XXXVII for the purpose of setting forth an Initial Allocation Plan for the proposed Boston Options Exchange facility ("BOX").<sup>3</sup> Proposed new language is *italicized*.

\* \* \* \* \*

### Chapter XXXVII

*Boston Options Exchange, Inc.*

Initial Class Allocation—Parameters and Criteria

*Sec. 1. In order to manage the initial allocation of classes for the proposed Boston Options Exchange ("BOX"), the BSE intends to launch trading on the proposed BOX market for the top 250 classes (as determined by OCC volume statistics). 1886 assignments will be allocated first, to be phased in for trading during the first three months following the launch date. The remaining assignments within the initial 250 classes will be allocated on a class by class basis during the following three months.*

*(a) Parameters. The following categories and criteria are the basis for the initial allocation process.*

Category	Ranking of classes	Number of market makers per class	OCC average daily volume (No. of contracts)
A .....	1	12	>100,000.
B .....	2-6	12	50,000 to 99,999.
C .....	7-11	12	25,000 to 49,999.

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Securities Exchange Act Release No. 47186 (January 14, 2003), 68 FR 3062 (January 22, 2003) (SR-BSE-2002-15).