

exception solely related to the provision of non-audit services for an issuer. This exception waives the pre-approval requirements for non-audit services provided that: (1) All such services do not aggregate to more than five percent of total revenues paid by the audit client to its accountant in the fiscal year when services are provided, (2) were not recognized as non-audit services at the time of the engagement, and (3) are promptly brought to the attention of audit committee and approved prior to the completion of the audit by the audit committee or one or more designated representatives. Lastly, as further discussed later in this release, the audit committee's policies for pre-approvals of services should be disclosed by registrants in periodic annual reports.

As noted earlier, the proposed rules provided two alternatives related to pre-approval of permissible non-audit services as well as all audit, review, or attest engagements required under the securities laws: either pre-approval before the accountant is engaged to provide the services or the engagement is entered into pursuant to detailed pre-approval policies and procedures established by the audit committee, with the audit committee informed on a timely basis of each service. In response to issues raised by commenters, the final rule has been modified to remove the appearance of an implicit preference of one alternative over another.

With respect to investment companies, the proposed rule would have required pre-approval not only of the non-auditing services provided to the investment company, but also require pre-approval by the investment company's audit committee of the non-auditing services provided to the investment company's investment adviser and any entity controlling, controlled by, or under common control with the investment adviser that provides services to the investment company.

Commenters<sup>160</sup> expressed concern over the breadth of this proposed rule and the unintended consequences of the pre-approval process. Commenters<sup>161</sup> observed that an auditor could provide a non-audit service to an entity in an investment company complex that would require the pre-approval of multiple audit committees. Some

commenters<sup>162</sup> indicated investment company complexes often have more than one audit committee for the various investment companies in the complex. Additionally, the other entities in the complex, themselves, will often have their own audit committees. As proposed, the rule would require not only the audit committee of the entity engaging the auditor to provide the non-audit service to pre-approve the use of the accountant, but also would require each audit committee of an investment company registrant in the complex to pre-approve the use of the accountant. This would ultimately result in each investment company audit committee having veto power over all non-audit services provided to the complex even if those services did not relate directly to the financial reporting or operations of the investment company. One commenter<sup>163</sup> expressed concern over the burden this would place on the investment company's audit committee. Other commenters<sup>164</sup> expressed concern with whether the members of the audit committee would be capable of evaluating the appropriateness of services provided to entities unrelated to the investment company's operations or financial reporting.

Commenters<sup>165</sup> suggested the rule should require the audit committee of the investment company to only pre-approve those audit and non-audit services provided directly to the investment company. One commenter<sup>166</sup> suggested the rule should require the audit committee of the investment company to pre-approve those audit and non-audit services that relate to the operations of the investment company.

After considering the comments, we believe modifying the approach by requiring the pre-approval of non-audit services to only those provided to the investment company directly, as suggested by several of the commenters, would not be consistent with the spirit or intent of the Sarbanes-Oxley Act. To address the commenters' concerns, but preserve the intent of the legislation, the rules as adopted would limit the investment company's audit committee pre-approval responsibility to those

services provided directly to the investment company and those services provided to an entity in the investment company complex where the nature of the services provided have a direct impact on the operations or financial reporting of the investment company. The final rules would allow the investment company's audit committee to assess and determine before the work is conducted the impact that the services might reasonably have on the investment company accountant's independence as it relates to the audits of the investment company's financial statements. In addition, in response to one commenter's<sup>167</sup> suggestion concerning the non-audit services that should be disclosed, we have clarified the entities that provide services to the investment company that must be pre-approved. As adopted only the service providers that provide "ongoing" services to the investment company must have their non-audit services pre-approved. Thus, the final rules would limit the number of instances where pre-approval would be sought from multiple audit committees in the complex.

Although it may not be practical or feasible for the investment company audit committee to pre-approve all services provided to the investment company complex, we continue to believe the audit committee should be aware of all services the accountant is providing to entities in the investment company complex. One commenter<sup>168</sup> agreed with this position suggesting non-audit services be disclosed quarterly. As a result, we are adopting a requirement in the rule that the accountant disclose to the audit committee all services provided to the investment company complex, including the fees associated with those services.

The *de minimis* exception that was proposed would have calculated the percentage threshold based on the total revenues paid to the investment company's accountant by the investment company, its investment adviser and any entity controlling, controlled by, or under common control with the investment adviser that provided services to the investment company. We asked for comment on the appropriate methodology for calculating the *de minimis* exception. One commenter<sup>169</sup> suggested it would be

<sup>160</sup> See, e.g., letter from Deloitte & Touche, dated January 10, 2003; letter from Ernst & Young, dated January 6, 2003; letter from Investment Company Institute, dated January 13, 2003.

<sup>161</sup> See, e.g., letter from Ernst & Young, dated January 6, 2003; letter from Deloitte & Touche, dated January 10, 2003; letter from PricewaterhouseCoopers, dated January 8, 2003.

<sup>162</sup> See, letter from PricewaterhouseCoopers, dated January 8, 2003; letter from Investment Company Institute, dated January 13, 2003.

<sup>163</sup> See, letter from Investment Company Institute, dated January 13, 2003.

<sup>164</sup> See, letter from PricewaterhouseCoopers, dated January 8, 2003; letter from Deloitte & Touche, LLP, dated January 10, 2003.

<sup>165</sup> See, letter from Ernst & Young, LLP, dated January 6, 2003; letter from Investment Company Institute, dated January 13, 2003.

<sup>166</sup> See, letter from PricewaterhouseCoopers, dated January 8, 2003.

<sup>167</sup> See, letter from PricewaterhouseCoopers, dated January 8, 2003.

<sup>168</sup> See, letter from KPMG, LLP, dated January 9, 2003.

<sup>169</sup> See, letter from PricewaterhouseCoopers, dated January 8, 2003.