

audit and non-audit fees from services provided directly to the investment company and those non-audit fees from services provided to all other entities in the investment company complex where the services were subject to pre-approval by the investment company's audit committee. Like an operating company, the investment company would be required to disclose the percentage of fees for each category of fees that were pre-approved pursuant to the *de minimis* exception. The final rules require disclosure of the total non-audit fees paid to the accountant, regardless of whether those fees were pre-approved by the investment company's audit committee, by the investment company, its adviser, and any entity controlling, controlled by, or under common control with the investment adviser that provides ongoing services to the fund. The final rule also will require the investment company to disclose if the audit committee has considered whether the provision of non-audit services provided to the investment company's adviser and its related parties that were not subject to the investment company audit committee's pre-approval is compatible with maintaining the principal accountant's independence.

These disclosure provisions are effective for periodic annual filings for the first fiscal year ending after December 15, 2003. We encourage issuers who have not previously issued their periodic annual filings to adopt these disclosure provisions earlier.

#### *I. International Impact*

The Commission realizes that these rules will have an international impact. It will affect foreign accounting firms that conduct audits of both foreign private issuers and foreign subsidiaries and affiliates of U.S. issuers. Through its participation in the International Organization of Securities Commissions and bilateral meetings, and through a roundtable held in Washington in December, the Commission has made a concerted effort to obtain the views of the international community of regulators, market participants and practitioners. Through this process and public consultation, the Commission has received valuable insight into various foreign regulatory regimes relating to auditor independence, and detailed and specific comments on the proposed rule.

The partner rotation requirements set forth in the proposed rule were of particular concern to the international community. The proposal, as mandated by the Act, called for the rotation of the lead and concurring partners on a five-

year basis. In addition, it precluded these partners from returning to an audit of the same registrant for five years. The proposal also applied the same rotation requirement to all partners on the audit engagement team. Commentators noted that the proposed requirements could have a particularly adverse impact in foreign countries, especially in emerging countries, where there may be a more limited pool of accountants and experts conversant in U.S. GAAP and U.S. GAAS. Other commentators indicated that the proposed rotation requirements would cause firms to rotate hundreds of partners in scores of countries. The resulting widespread rotation would affect audit quality adversely, and would be hard, if not impossible, to achieve practically.

We are extending the partner rotation requirements beyond the lead and concurring partners. However, taking into account these and other comments, the rotation will not be applied as broadly as proposed. We believe that partner rotation should be a function of the level of responsibility for decisions on accounting and financial reporting issues, and the level of interaction with senior management of an issuer. Accordingly, under the final rule, the rotation requirement will apply to partners that serve the client at the issuer or parent level. It also will apply to the lead partner serving an issuer's subsidiary whose revenues constitute 20% or more of the consolidated assets or revenues of the parent. Partners serving subsidiaries whose assets and revenues fall below the threshold are not subject to rotation. The same is true for partners, other than lead partners, serving subsidiaries above the threshold.

The international community also requested that the Commission modify its approach to conflicts of interest resulting from employment relationships. The Act requires a "cooling off" period of one year before a member of the audit engagement team can work for a registrant in certain key positions. Under the proposed rule, the restriction applied with regard to employment by the issuer and its affiliates. Some commentators stated that the rule should only apply to partners on the audit engagement team. Commentators also indicated that extending the requirement to apply with regard to key positions at the issuer and its affiliates was overbroad, difficult to monitor, and possibly impossible to control. Moreover, we have become aware that in certain jurisdictions the labor law or jurisprudence would prohibit foreign accounting firms from imposing restrictions on the future

employment opportunities of their personnel.

We agree that extending the requirement to the audit client might be difficult to monitor particularly in situations where a member of the audit engagement team begins employment with an affiliate of the issuer. Further, we recognize that in certain foreign jurisdiction it may be extremely difficult to comply with these requirements. In response to the concerns raised, the cooling-off period will apply to the lead, concurring partner or any other member of the audit engagement team, unless exempted, who provides more than ten hours of audit, review or attest services. The restriction on employment will apply only with regard to key positions at the issuer. Members of the audit engagement team, including those employed by a foreign accounting firm, will be able to take positions with the subsidiaries or affiliates of an issuer. They also may take key positions at the issuer in certain circumstances and upon the approval of the audit committee (or a similar body).

The Commission also has given consideration to comments regarding foreign requirements with respect to the provision of appraisal and valuation services. The Commission believes that the extension of these services to audit clients raises concerns with respect to the auditor's independence. The Commission is, therefore, eliminating some exemptions previously provided in this area. However, we understand that laws and regulations in certain foreign countries require auditors to provide contribution-in-kind reports or valuation services. The Commission has historically addressed conflicts between U.S. and foreign requirements regarding non-audit services on an *ad hoc* basis. Commission staff has previously afforded relief from proscriptions against appraisal and valuation services where, among other things, the auditor and issuer were able to demonstrate that the auditor was not providing an opinion on the fairness of a given transaction. The Commission will continue to take this *ad hoc* approach, and will continue to consider requests for exemptive relief from foreign auditors.

Finally, several foreign commentators noted that a prohibition on legal services could amount to a prohibition on the provision of tax services by foreign accounting firms from particular jurisdictions. It would appear that in certain jurisdictions tax services are defined as legal services and can only be rendered by persons licensed to practice law. The Commission is making clear that foreign accounting firms can