

audit fees paid to the accountant by any entity in the investment company complex that was not subject to pre-approval by the investment company's audit committee.

Because of existing GAAS and legal provisions,²⁸⁵ we believe that the final rules regarding accountants' reports to audit committees will not significantly increase costs for accounting firms or registrants. Any such costs may arise from the timing of the communications,²⁸⁶ which must occur before the auditor's report is filed with the Commission. We also believe limiting the reporting requirement to only material alternative treatments will reduce unnecessary costs. The required reports need not be in writing, but the report is required to be presented to the audit committee before the auditor's report is filed with the Commission.

3. Enhanced Disclosures About the Services Provided by Auditors to Registrants

The existing proxy disclosure rules require disclosure of all professional fees billed by the principal auditor in the last fiscal year, with the fees broken down into three categories: audit fees, financial information systems design and implementation fees, and all other fees. The final rules divide the disclosure into two more categories—tax fees and audit-related fees—and add disclosure of one more year of these fees while eliminating separate disclosure of fees related to financial information systems design and implementation.²⁸⁷ The final rules also require companies that do not file proxy statements to file this information with the Commission in their annual reports on Forms 10-K and 10-KSB, foreign private issuers to file the information on Form 20-F, certain Canadian issuers to file the information on Form 40-F, and registered management investment

companies to file the information on Form N-CSR.²⁸⁸

Registrants also are required to disclose the audit committee's policies and procedures for approval of services provided by the accounting firm, and the percentage of fees in each of the four categories noted above (audit, audit-related, tax, and all other) where the audit committee used the *de minimis* exception to the pre-approval requirements.²⁸⁹

Based on the staff's experience, we believe that the additional disclosure contemplated by the final rules will require, on average, approximately one-half of a page in a company's proxy statement or annual report. Accordingly, we believe the additional printing costs from these additional disclosures will be small.

Using estimates derived from our Paperwork Reduction Act analysis, we estimate that the incremental impact of the disclosure changes will result in a total cost of \$5,862,400 for all affected filers. The estimate is based on the burden hour estimates calculated under the Paperwork Reduction Act. For purposes of the Paperwork Reduction Act, we estimate that the additional disclosure will result in 26,678 internal burden hours and \$2,999,400 in external costs. Assuming a cost of \$125/hour for in-house professional staff (and \$40 per hour for internal staff review for Form N-CSR), the total cost for the internal burden hours would be \$2,863,000.²⁹⁰ Hence the aggregate cost estimate is \$5,862,400 (\$2,863,000 + \$2,999,400).

4. Transition

In response to the concerns of several commenters, we are providing a

²⁸⁸ Form 10-K is the annual report that registrants file with the Commission pursuant to Section 13 or 15(d) of the Exchange Act, if no other annual reporting form has been prescribed. Small business issuers may use abbreviated Form 10-KSB. A "small business issuer" is an entity that (1) has revenues of less than \$25,000,000, (2) is a U.S. or Canadian issuer, (3) is not an investment company, and (4) if a majority owned subsidiary, the parent corporation is also a small business issuer. An entity is not a "small business issuer," however, if the aggregate market value of its outstanding voting and non-voting common stock held by non-affiliates is \$25,000,000 or more. See, 17 CFR 240.12b-2. Registered management investment companies would use Form N-CSR to file certified shareholder reports with the Commission under the Sarbanes-Oxley Act of 2002.

²⁸⁹ With respect to investment companies, the final rules also will require disclosure of all non-audit fees paid to the investment company's accountant by all entities in the investment company complex, and whether the audit committee considered those non-audit services in evaluating the auditor's independence with respect to the investment company.

²⁹⁰ The \$125/hour cost estimate is based on data obtained from *The SIA Report on Management and Professional Earnings in the Securities Industry* (Oct. 2001).

transition period for several of the requirements of the final rules. A transition period helps to alleviate the immediate impact of any costs and burdens that may be imposed on certain registrants and their accounting firms. A transition period may even help reduce costs as registrants and accounting firms will have additional time to adjust their processes and procedures to the new requirements.

V. Consideration of Burden on Competition, and Promotion of Efficiency, Competition, and Capital Formation

Section 23(a)(2) of the Exchange Act²⁹¹ requires the Commission, when adopting rules under the Exchange Act, to consider the anti-competitive effects of any rule it adopts. In addition, Section 2(b) of the Securities Act of 1933,²⁹² Section 3(f) of the Exchange Act,²⁹³ and Section 2(c) of the Investment Company Act²⁹⁴ require the Commission, when engaging in rulemaking that requires it to consider or determine whether an action is necessary or appropriate in the public interest, to consider whether the action will promote efficiency, competition, and capital formation.

The rules prohibit the independent accounting firm from providing certain non-audit services for their audit clients. These rules, therefore, could result in some companies seeking new accounting firms for non-audit services permitted under our previous rules, but not allowed under the Sarbanes-Oxley Act and the final rules. This may have an impact on competition for those services, although to the extent the new vendor is another accounting firm, the result may redistribute services among firms rather than an increase or decrease in services.

The proposed rules may have disadvantaged smaller accounting firms because of the partner rotation requirements, since smaller firms may not have other partners available to continue providing audit services to the client. We have modified the final rules to mitigate this concern. Under the final rules, accounting firms with fewer than five audit clients and fewer than ten partners may be exempted from the audit partner rotation and compensation requirements.

One possible adverse impact on capital formation may come from additional costs related to audit committees. Although the final rules do

²⁹¹ 15 U.S.C. 78w(a)(2).

²⁹² 15 U.S.C. 77b(b).

²⁹³ 15 U.S.C. 78c(f).

²⁹⁴ 15 U.S.C. 80a-2(c).

²⁸⁵ See, Item 303 of Regulation S-K, 17 CFR 229.303; Release No. 33-8040 (Dec. 12, 2001); and SAS 61, "Communication with Audit Committees or Others with Equivalent Authority and Responsibility," AU § 380.

²⁸⁶ An investment company's auditor will only be required to communicate this information to the audit committee annually, unless there have been changes from the previously-reported information and the annual communication was completed more than 90 days prior to the filing. This should reduce the cost for investment companies to comply with this requirement.

²⁸⁷ In the case of investment companies, the investors will receive this information for the investment company registrant and separately, for all other entities in the investment company complex where the services were subject to pre-approval by the investment company's audit committee.