Sarbanes-

By Frank C. Minter, CPA, and Douglas L. Smith, CMA, CPA

Invoices will soon be arriving at the offices of all public companies so they can provide the financial support for a standards-setting body and an oversight board as required by the Sarbanes-Oxley Act of 2002. Companies need to be aware of this little-mentioned stipulation so they won't be taken by surprise.

We aren't going to describe the various provisions of the Sarbanes-Oxley Act, as most financial professionals are familiar with them by now. Let's just say they cover topics such as auditor independence, financial disclosures, fraud accountability, and others. Many are designed to deal with both actual and perceived independence of the auditor and the accounting standards-setting body, i.e., the Financial Accounting Standards Board (FASB).

OVERSIGHT BOARD

For some background, though, Title I of the Act—"Public Company Accounting Oversight Board"—establishes the independent PCAOB (which won't be an agency of the U.S. government) to "oversee the audit of public companies…and further the public interest in the preparation of informative, accurate, and independent audit reports…" Among its prescribed duties, the Board will:

1. Register public accounting firms that prepare audit reports for issuers…;

2. Establish or adopt, or both, by rule, auditing, quality control, ethics, independence, and other standards relating to the preparation of audit reports for issuers…;

3. Conduct inspections of registered public accounting firms…;

4. Conduct investigations and disciplinary proceedings concerning, and impose appropriate sanctions where justified upon, registered public accounting firms and associated persons of such firms…;

5. Perform such other duties or functions as…are necessary or appropriate to promote high professional standards among, and improve the quality of audit services offered by, registered public accounting firms and associated persons thereof…in order to protect investors, or to further the public interest;

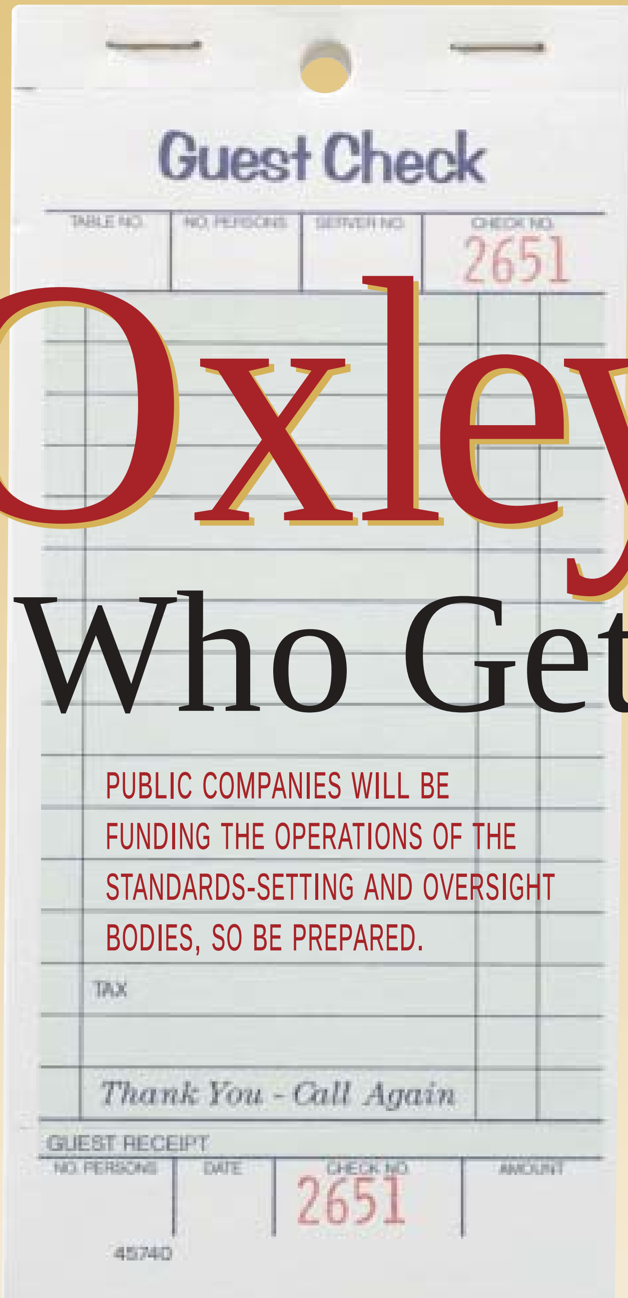
6. Enforce compliance with this Act, the rules of the Board, professional standards, and the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto…; and

7. Set the budget and manage the operations of the Board and the staff of the Board.

Two notes: While use of the term "issuer" is somewhat unclear, it generally denotes an issuer of securities, or a publicly traded company. Also, much of the work that

Oxley Act

Who Gets the Bill?



PUBLIC COMPANIES WILL BE FUNDING THE OPERATIONS OF THE STANDARDS-SETTING AND OVERSIGHT BODIES, SO BE PREPARED.

will become the responsibility of the Oversight Board is currently performed by the AICPA and its committees, such as the Auditing Standards Board.

Another provision of the Act is that the PCAOB will take action that will enable the Securities & Exchange Commission (SEC) to determine that the Board has the capacity to carry out its responsibilities no later than 270 days after enactment of the Act, i.e., April 26, 2003. The Act further provides that the SEC may recognize as "generally accepted" for purposes of the securities laws any accounting principles established by a standards-setting body that is organized as a private entity and has an oversight board of trustees "serving in the public interest." We understand that this would be the FASB, although the SEC hasn't yet officially recognized it as this entity.

HOW WILL THE FUNDING WORK?

Section 109 of Title I provides that both the Board and the standards-setting body will be funded through "annual accounting support fees" that aren't to be considered U.S. public monies. These fees, which will approximate the annual budgets of the two Boards, will be assessed and collected from each issuer and may differentiate between classes of issuers. The Act stipulates that the total amount due from each issuer (or class of issuers) will be calculated "in an amount equal to the total amount, multiplied by a fraction—the numerator of which is the average monthly equity market capitalization of the issuer for the 12- month period immediately preceding the beginning of the fiscal year to which such budget relates; and the denominator of which is the average monthly equity market capitalization for all such issuers for that 12-month period."

At present, it isn't clear whether there will be some reasonableness approach applied to the method of calculation. Without trying to be absolutely precise, let's assume there are approximately 13,000 public companies regulat-

Table 1: **Estimated Support Fees for Companies with the Largest Market Capitalization**

SYMBOL	COMPANY NAME	MARKET CAPITALIZATION (000,000)	PERCENT OF TOTAL MARKET	ACCOUNTING SUPPORT FEE ($)
GE	GENERAL ELECTRIC COMPANY	307,555	1.7086%	$1,281,479
MSFT	MICROSOFT CORPORATION	298,886	1.6605%	1,245,358
XOM	EXXON MOBIL CORPORATION	259,388	1.4410%	1,080,783
WMT	WAL-MART STORES INCORPORATED	244,270	1.3571%	1,017,792
PFE	PFIZER INCORPORATED	216,180	1.2010%	900,750
C	CITIGROUP INCORPORATED	203,453	1.1303%	847,721
JNJ	JOHNSON & JOHNSON	176,494	0.9805%	735,392
AIG	AMERICAN INTERNATIONAL GROUP	173,088	0.9616%	721,200
BP	BP PLC ADS	170,753	0.9486%	711,471
INTC	INTEL CORPORATION	154,936	0.8608%	645,567
IBM	INTERNATIONAL BUSINESS MACHINES	143,640	0.7980%	598,500
GSK	GLAXOSMITHKLINE PLC ADR	126,749	0.7042%	528,121
MRK	MERCK & COMPANY INCORPORATED	124,090	0.6894%	517,042
KO	COCA-COLA COMPANY	123,246	0.6847%	513,525
PG	PROCTER & GAMBLE COMPANY	122,432	0.6802%	510,133
VOD	VODAFONE GROUP PLC ADR	115,334	0.6407%	480,558
BRKB	BERKSHIRE HATHAWAY INC CL B	109,378	0.6077%	455,742
BRKA	BERKSHIRE HATHAWAY INC	109,367	0.6076%	455,696
HBC	HSBC HOLDINGS PLC	108,347	0.6019%	451,446
BAC	BANK OF AMERICA CORPORATION	107,461	0.5970%	447,754
CSCO	CISCO SYSTEMS INCORPORATED	107,351	0.5964%	447,296
VZ	VERIZON COMMUNICATIONS CORP	107,181	0.5955%	446,588
SBC	SBC COMMUNICATIONS INCORPORATED	101,675	0.5649%	423,646
NVS	NOVARTIS AG ADR	101,492	0.5638%	422,883
MO	PHILIP MORRIS COMPANIES	101,361	0.5631%	422,338

ed by the SEC, including some foreign companies. Of these, only about 7,400 are listed on major stock exchanges. Currently, only about 1,100 of such companies have a market capitalization in excess of $1 billion. This raises the question as to whether the SEC and the Board will provide some cut-off whereby every issuer whose market capitalization falls below that point will be assessed the same dollar amount.

Let's look at an example that's made up of a number of assumptions. First, we estimate that the combined annual budgets for the PCAOB and the standards-setting body will amount to some $75 million. Second, we estimate the total market capitalization of all issuers as being in the range of $18 trillion. (We know that the total market capitalization of 1,100 companies whose capitalization individually exceeds $1 billion is about $15.7 trillion.) The average market capitalization for individual companies we list here (see Table 1) is probably the closest to actual results, but both the $75 million amount for the budget and the $18 trillion total for market capitalization must be viewed as "soft."

Using General Electric as an example, since it had the highest market capitalization average for the year 2002, the result would be:

$$\frac{\$307{,}555\text{ billion}}{\$18\text{ trillion}} = .0170863 \quad\text{or}\quad 1.70863\%\text{ of total}$$

This fraction would be calculated for each issuer, using its own market capitalization and multiplied by the total budget, which in our example is $75 million. That means

At the time of this writing, a great deal is still unresolved. The details of the Act are a moving target and may not be completely defined for some time. SEC Chairman Harvey Pitt resigned in November, and the Senate hasn't yet confirmed William Donaldson as his replacement. The chief accountant of the SEC also resigned. William Webster, the initially appointed chair of the PCAOB, resigned shortly after appointment as the result of his involvement on an audit committee of a company that was under review by the SEC. Charles Niemeier was named acting chair until the SEC can find a replacement. Donaldson has stated that finding a PCAOB chair will be his first priority after his confirmation as SEC chairman. In addition, the SEC has not yet recognized the FASB as the entity to prescribe generally accepted accounting principles. Since the Act also provides that the standards-setting body designated by the SEC be funded in the same manner as the PCAOB, these delays also impact that body.

GE would be billed for about $1,281,500 for the year 2003. A second example is a company with which we both have experience: BellSouth, with an average market capitalization of $56,030 billion, would be assessed $233,500 for 2003.

Table 1 presents the estimated amounts for the 25 companies with the largest market capitalization values. We make the same assumptions for the smaller companies as follows:

MARKET CAP	ANNUAL ACCOUNTING SUPPORT FEE
$1 billion	$ 4,162
$500 million	2,078
$250 million	1,035
$100 million	412

Once the budget and total market capitalization amounts become more firm, any individual public company can easily calculate a rough estimate of the assessment amount they will be billed by following the steps outlined here. For example, for each $1 trillion difference from the $18 trillion, there would be approximately a 5% change in the accounting fee for a company. It probably doesn't make sense for all of the smaller public companies to make individual calculations. Since the Act provides for differentiation among classes of issuers, it would make sense for some flat fee to be levied on all issuers below a specific market cap, perhaps in the $500 million range.

Here are some other questions for which there are not yet answers:

1. Who will calculate the average market capitalization for each company? The 10-K is certainly a vehicle, but that would present difficulties for fiscal-year companies as well as cash-flow problems for the two Boards, who could not even issue invoices until April of each year.

2. Will there be a separate bill issued for each of the two Boards or a single bill whereby one Board will remit to the other Board?

3. The Act makes no reference to uncollectible invoices, which should be rare, or to merging companies or companies going out of business, but that would have some impact on the budgets of the Boards.

DON'T WAIT

Our primary reason for writing this article now, even though much is still uncertain, is our belief than a great many companies, including some large ones, haven't yet focused on this item in their operating budgets, particularly as most of the work that the Act will require of the two Boards is already being done by others and funded in different ways. For example, for most of its existence the FASB has been supported in part through voluntary contributions of its constituents throughout the profession. Sarbanes-Oxley eliminated this source of support because Congress was concerned about the Board's independence from its contributors. As a result of the funding plan in the Act, these costs are largely being shifted to issuers.

Once the new SEC chairman is confirmed, things should begin to move more quickly. A chairman of the PCAOB will be selected, a new chief accountant of the SEC will be appointed, staff of the PCAOB can be hired, and the billing processes will be developed. But companies shouldn't wait—they should begin planning now for the financial impact of the Act. ■

Frank C. Minter, CPA, is Executive-in Residence, and Douglas L. Smith, CMA, CPA, Ph.D., is director of graduate studies and on the accounting faculty in the School of Business at Samford University in Birmingham, Ala. You can reach Frank at fcminter@samford.edu and Doug at dusmith @samford.edu.