

process.⁴⁹ One commenter stated that the “cast doubt” language in the proposed rule might deter auditors from asking legitimate questions.⁵⁰

Some commenters suggested language to replace the provision in subparagraph (c) that documents be retained if they “cast doubt on the final conclusions reached by the auditor.” For example, commenters suggested that records be retained only if they would constitute a reportable “disagreement” under Item 304 of Regulation S-K.⁵¹ Item 304 indicates that a disagreement is reportable upon a change in an entity’s principal accountant if, among other things, the disagreement occurs at the decision-making level on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, which, if not resolved to the accountant’s satisfaction, would cause the auditor to make reference to the matter in connection with his or her audit report.⁵²

We are reluctant, however, to follow Item 304 of Regulation S-K, which has a different purpose than the rule being adopted in this release. Item 304 requires disclosure to investors of potential “opinion shopping” situations and provides a forum for the registrant, the newly engaged auditor, and the former auditor to provide their views of “disagreements” and other “reportable events.” New rule 2-06, on the other hand, addresses the retention of documents relevant to enforcement of the securities laws, Commission rules, and criminal laws.

In the proposing release we asked if, in place of the “cast doubt” language, a different test for retention of documents would be appropriate. We specifically asked if such a test should be documentation of “significant differences in professional judgment” or “differences of opinion on issues that are material to the issuer’s financial statements or to the auditor’s final conclusions regarding any audit or review.” Several commenters supported using one or a combination of these tests.⁵³

In consideration of the comments received, we have revised paragraph (c) of the rule. We have removed the phrase “cast doubt” to reduce the possibility that the rule mistakenly would be interpreted to reach typographical errors, trivial or “fleeting” matters, or errors due to “on-the-job” training. We continue to believe, however, that records that either support or contain significant information that is inconsistent with the auditor’s final conclusions would be relevant to an investigation of possible violations of the securities laws, Commission rules, or criminal laws and should be retained. Paragraph (c), therefore, now provides that the materials described in paragraph (a) shall be retained whether they support the auditor’s final conclusions or contain information or data, relating to a significant matter, that is inconsistent with the final conclusions of the auditor on that matter or on the audit or review. Paragraph (c) also states that the documents and records to be retained include, but are not limited to, those documenting consultations on or resolutions of differences in professional judgment.

The reference in paragraph (c) to “significant” matters is intended to refer to the documentation of substantive matters that are important to the audit or review process or to the financial statements of the issuer or registered investment company.⁵⁴ Rule 2-06(c)

December 27, 2002; letter from KPMG LLP dated December 27, 2002; letter from the American Institute of Certified Public Accountants dated December 27, 2002.

⁵⁴ SAS 96 requires the auditor to document findings or issues that in his or her judgment are significant. It states that “significant audit findings or issues” include:

- “Matters that both (a) are significant and (b) involve issues regarding the appropriate selection, application, and consistency of accounting principles with regard to the financial statements, including related disclosures. Such matters often relate to (a) accounting for complex or unusual transactions or (b) estimates and uncertainties and, if applicable, the related management assumptions.
- “Results of auditing procedures that indicate that (a) the financial statements or disclosures could be materially misstated or (b) auditing procedures need to be significantly modified.
- “Circumstances that cause significant difficulty in applying auditing procedures that the auditor considered necessary.
- “Other findings that could result in modification of the auditor’s report.” SAS 96, ¶ 9, AU § 339.09 (Footnote omitted.)

This literature may provide helpful guidance as to the scope of the term “significant.” However, the term significant as used in this rule is not limited to items identified in SAS 96. Moreover, we do not intend for the auditor’s subjective judgment of whether a matter is significant to be determinative. Instead, we believe that the more objective test of what may be significant to a reasonable investor should be applied in evaluating whether information is “significant.”

requires that the documentation of such matters, once prepared, must be retained even if it does not “support” the auditor’s final conclusions, because it may be relevant to an investigation.⁵⁵ Similarly, the retention of records regarding a consultation about, and resolution of, differences in professional judgment would be relevant to such an investigation and must be retained. We intend for Rule 2-06 to be incremental to, and not to supersede or otherwise affect, any other legal or procedural requirement related to the retention of records or potential evidence in a legal, administrative, disciplinary, or regulatory proceeding.

Finally, we recognize that audits and reviews of financial statements are interactive processes and views within an accounting firm on accounting, auditing or disclosure issues may evolve as new information or data comes to light during the audit or review. We do not view “differences in professional judgment” within subparagraph (c) to include such changes in preliminary views when those preliminary views are based on what is recognized to be incomplete information or data.

Response to Other Significant Comments

In response to our request in the Proposing Release, commenters addressed whether issuers and registered investment companies should be required to retain documents that the auditor examines, reviews or otherwise considers during the audit or review but are not made part of the auditor’s records. Commenters generally opposed such a requirement.⁵⁶ One commenter indicated that it was unclear whether section 802 of the Sarbanes-Oxley Act applies to such records and that, if such a requirement was imposed, it would go beyond those documents that are relevant to the audit or review or that contain the auditor’s conclusions, opinions, or analyses.⁵⁷ An accounting firm similarly stated that it was not practical for an issuer to keep track of the documents examined by the auditor and then apply the retention

⁴⁹ Letter from Donald D. Pangburn, Director, Gelfond Hochstadt Pangburn, P.C., dated November 26, 2002.

⁵⁰ Letter from Sullivan & Cromwell dated December 26, 2002.

⁵¹ See, e.g., letter from Ernst & Young LLP, dated December 27, 2002; letter from PricewaterhouseCoopers dated December 27, 2002; letter from Deloitte & Touche dated December 27, 2002.

⁵² Item 304 of Regulation S-K, 17 CFR 229.304.

⁵³ See, e.g., letter from Sullivan & Cromwell dated December 26, 2002; letter from Lynette Downing, HLB Tautges Redpath, Ltd. dated December 27, 2002; letter from Grant Thornton LLP dated

⁵⁵ See letter from Deloitte & Touche dated December 27, 2002, quoting Statement of Senator Orrin Hatch before the Senate Judiciary Committee (April 25, 2002): “I anticipate that the SEC will exercise its discretion to promulgate only those rules and regulations that are necessary to ensure that documents material to an audit or review, as well as any future investigation, are retained.”

⁵⁶ One commenter supported such a requirement. Letter from Lynette Downing, HLB Tautges Redpath, Ltd. dated December 27, 2002.

⁵⁷ Letter from Sullivan & Cromwell dated December 26, 2002.