

the retention of records currently are made as a part of each audit or review.

In the proposing release, we estimated that adoption of the rule would not result in any significant increase in costs for accounting firms or issuers because the rule would not require the creation of records, would not significantly increase procedures related to the review of documents, and minimal, if any, work would be associated with the retention of these records. We indicated that the disposal of those records, which would occur in any event, merely would be delayed. In addition, because an already large and ever-increasing portion of the records required to be retained are kept electronically, we stated that the incremental increase in storage costs for documents would not be significant for any firm or for any single audit client. We recognize, however, that firms may incur some cost to retain access to older technologies as electronic storage technology advances.

For purposes of the Paperwork Reduction Act, we estimated in the proposing release the total burden to be 15,000 burden hours. We further estimated that, assuming an accounting firm's average cost of in-house staff is \$110 per hour,⁷⁵ the total cost would be \$1,650,000.

We received comments indicating that, based on the proposed rule, our cost estimate was low. Due to revisions made to the rule the cost estimates provided by the commenters, however, may no longer be accurate. For example, a large accounting firm stated that if it would be required to retain all financial data "received" from the issuer in the course of the audit, its current document retention costs of approximately \$4.5 million would double.⁷⁶ This firm questioned whether all of the issuer's financial information, records, databases, and reports that the auditor examines on the issuer's premises, but are not made part of the auditor's workpapers or otherwise retained by the auditor, would be deemed to be "received" by the auditor and subject to the retention requirements in rule 2-06. As noted

previously in this release, we do not believe that Congress intended for accounting firms to duplicate and retain all of the issuer's financial information, records, databases, and reports that might be read, examined, or reviewed by the auditor. Accordingly, we do not believe that the "received" criterion in rule 2-06(a)(1) requires that auditors retain such records and the firm's anticipated document retention costs, therefore, should be significantly reduced.

Another accounting firm indicated that administrative costs of retaining records, based on the proposed rule, could include a one-time cost of \$1 million and ongoing annual costs of \$500,000 to \$1 million.⁷⁷ This firm also estimated that increased litigation costs associated with complying with discovery requests and payment of damages would increase annual audit costs by at least five percent and perhaps as much as fifteen to twenty percent.⁷⁸ As noted above, we believe that revisions to the rule in response to commenters' concerns should lessen the administrative costs anticipated by this commenter. Regarding the commenter's cost estimates related to potential litigation, we recognize that one purpose of section 802 is to facilitate investigations of potential violations of securities laws and criminal laws,⁷⁹ which could impact a firm's litigation costs. Nonetheless, the firm's estimate would appear to be speculative. If the retention requirements lead to more efficient oversight of the accounting profession then they may result in improved audit quality and enhanced investor confidence in the profession.

Other accounting firms noted that many variables would affect the costs related to the rule, and that the ultimate increase in costs is difficult to quantify.⁸⁰ One commenter indicated that the amount of changes to be made to current record retention systems, and the related costs, depends on whether the accounting firm has a good record management system already in place.⁸¹

⁷⁷ Letter from BDO Seidman, LLP dated December 27, 2002.

⁷⁸ *Id.*

⁷⁹ See Statement of Senator Leahy on the Senate floor: "[I]t is intended that the SEC promulgate rules and regulations that require the retention of such substantive material * * * for such a period as is reasonable and necessary for effective enforcement of the securities laws and the criminal laws." * * * 148 Cong. Rec. S7419 (July 26, 2002).

⁸⁰ See, e.g., letter from Grant Thornton, dated December 27, 2002.

⁸¹ Letter from Lynette Downing, HLB Tautges Redpath, Ltd., dated December 27, 2002. This commenter estimated that, depending on the information systems and staff currently in place, to maintain electronic records "an investment of \$100,000 to \$250,000 for each \$5 million in net fees

For those firms with established records management programs, this commenter indicated that the rule would require a review and possibly fine-tuning of the firms' existing policies and procedures. This commenter also noted that adopting the proposed five-year retention requirement would have been more costly than adopting the seven-year retention requirement that is consistent with the forthcoming auditing standard to be promulgated by the Public Company Accounting Oversight Board. In this commenter's view, having two retention periods would have increased costs associated with processing the records.⁸²

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

Section 23(a)(2) of the Exchange Act⁸³ 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 1933,⁸⁴ Section 3(f) of the Exchange Act,⁸⁵ and Section 2(c) of the Investment Company Act⁸⁶ 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.

We believe that rule 2-06 would not have an adverse impact on competition. To the extent the proposed rules would increase the quality of audits and the efficiency of enforcement and disciplinary proceedings, there might be an increase in investor confidence in the efficacy of the audit process and the efficiency of the securities markets.

One commenter agreed that the rule should have no adverse effect on competition.⁸⁷ This commenter also noted that those firms with good records management systems should have more efficient services and more secure information.⁸⁸

In any event, to the extent the rule has any anti-competitive effect, or impacts efficiency, competition, or capital formation, we believe those effects are necessary and appropriate in

is likely with ongoing annual expenses of \$50,000 to \$100,000."

⁸² *Id.*

⁸³ 15 U.S.C. 78w(a)(2).

⁸⁴ 15 U.S.C. 77b(b).

⁸⁵ 15 U.S.C. 78c(f).

⁸⁶ 15 U.S.C. 80a-2(c).

⁸⁷ Letter from Lynette Downing, HLB Tautges Redpath, Ltd., dated December 27, 2002.

⁸⁸ *Id.*

⁷⁵ We estimate that associates would perform three-fourths of the required work, with a partner performing about one-fourth of the work. We also estimate that, on average, an associate's annual salary would be approximately \$125,000 and a partner's annual compensation would be approximately \$500,000. Based on these amounts, the in-house cost of an associate's time would be approximately \$65 per hour, and the in-house cost of a partner's time would be approximately \$250 per hour. The average hourly rate, therefore, would be about \$110 per hour $((3 \times \$65) + \$250) / 4$.

⁷⁶ Letter from PricewaterhouseCoopers dated December 27, 2002.