

furtherance of the goals of implementing section 802 of the Sarbanes-Oxley Act.

We received no comments indicating that the rule would impact efficiency or capital formation.

## VI. Final Regulatory Flexibility Act Analysis

This Final Regulatory Flexibility Act Analysis has been prepared in accordance with 5 U.S.C. 604. It relates to new rule 2-06 of Regulation S-X, which requires auditors to retain certain audit and review documentation.

### A. Reasons for and Objectives of the New Rule

The rule generally carries out a congressional mandate. The rule, in general, prohibits the destruction for seven years of certain records related to the audit or review of an issuer's or registered investment company's financial statements.<sup>89</sup> The rule, however, would not require accounting firms to create any new records.

The objective of the rule is to implement section 802 of the Sarbanes-Oxley Act in order to increase investor confidence in the audit process and in the reliability of reported financial information. This is accomplished by defining the records to be retained related to an audit or review of an issuer's financial statements. Having these records available should enhance oversight of corporate reporting and of the performance of auditors and facilitate the enforcement of the securities laws.

### B. Significant Issues Raised by Public Comments

One commenter anticipated that the record retention requirements, if adopted as proposed, would have placed an "enormous" burden on small accounting firms, and could have resulted in some firms deciding to no longer audit public companies.<sup>90</sup> The final rule, however, contains several revisions designed to lower the costs on all firms, including smaller accounting firms. These revisions include removing the "cast doubt" language from the rule, which commenters generally viewed as requiring the auditor to retain virtually all documents generated or reviewed during an audit or review, regardless of their relevance or materiality.<sup>91</sup> We have replaced this language with

language that focuses on documents that contain information or data relating to a significant matter that are inconsistent with the auditor's final conclusions regarding that matter or the audit or review. We also have adopted a seven-year retention period to coincide with a forthcoming retention requirement to be promulgated by the Public Company Accounting Oversight Board, which, according to one commenter, should reduce processing costs associated with the rule.<sup>92</sup> Also, as noted above, we have clarified in this release that the auditor need not retain every document read, examined or reviewed as part of the audit or review process. As a result of these revisions and clarifications, we believe that implementation of the revised rule should be less costly for accounting firms than anticipated by the commenters.

Furthermore, one commenter noted that records management procedures for smaller accounting firms should be the same as they are for larger firms.<sup>93</sup> This commenter indicated that "the cost of implementing a [formalized records management] program at any-sized firm will be surpassed by the benefits received and the future cost savings."<sup>94</sup>

### C. Small Entities Subject to the Rule

Our rules do not define "small business" or "small organization" for purposes of accounting firms. The Small Business Administration defines small business, for purposes of accounting firms, as those with under \$6 million in annual revenues.<sup>95</sup> We have only limited data indicating revenues for accounting firms, and we cannot estimate the number of firms with less than \$6 million in revenues that practice before the Commission.

In the Initial Regulatory Flexibility Analysis we requested comment on the number of firms with less than \$6 million in revenue in order to determine the number of small firms potentially affected by the rule, but we received no response.

### D. Projected Reporting, Recordkeeping and Other Compliance Requirements

Under the new rule,<sup>96</sup> accountants who audit or review an issuer's or registered investment company's financial statements must retain certain records for a period of seven years from conclusion of the audit or review. The

records to be retained include records relevant to the audit or review, such as workpapers and other documents that form the basis of the audit or review and memoranda, correspondence, communications, other documents, and records (including electronic records), which are created, sent or received in connection with the audit or review, and contain conclusions, opinions, analyses, or financial data related to the audit or review. Records described in the rule would be retained whether the conclusions, opinions, analyses, or financial data in the records support the final conclusions reached by the auditor, or contain information or data, relating to a significant matter, that is inconsistent with the final conclusions of the auditor on that matter or the audit or review. The required retention of audit and review records should discourage the destruction, and assist in the availability, of records that may be relevant to investigations conducted under the securities laws.

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.

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,<sup>97</sup> 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

<sup>97</sup> 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  $((3 \times \$65) + \$250) / 4$ .

<sup>89</sup> See section 802 of the Sarbanes-Oxley Act.

<sup>90</sup> Letter from Grant Thornton LLP, dated December 27, 2002.

<sup>91</sup> See, e.g., letter from BDO Seidman, LLP, dated December 27, 2002; letter from Grant Thornton LLP dated December 27, 2002; letter from KPMG LLP dated December 27, 2002; letter from Deloitte & Touche LLP dated December 27, 2002.

<sup>92</sup> Letter from Lynette Downing, HLB Tautges Redpath, Ltd., dated December 27, 2002.

<sup>93</sup> Letter from Lynette Downing, HLB Tautges Redpath, Ltd., dated December 27, 2002.

<sup>94</sup> *Id.*

<sup>95</sup> 13 CFR 121.201.

<sup>96</sup> See section 802 of the Sarbanes-Oxley Act of 2002.