

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.⁹⁸ 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.⁹⁹ Accordingly, we do not believe that the "received" criterion in rule 2-06(a)(1) requires that the auditor 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.¹⁰⁰ 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.¹⁰¹ 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, Commission rules and criminal laws,¹⁰² 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.¹⁰³ 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.¹⁰⁴ 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.¹⁰⁵

E. Agency Action To Minimize Effect on Small Entities

The Regulatory Flexibility Act directs us to consider significant alternatives that would accomplish the stated objective, while minimizing any significant adverse impact on small entities. In connection with the proposed amendments, we considered the following alternatives:

1. The establishment of differing compliance or reporting requirements or timetables that take into account the resources of small entities;
2. The clarification, consolidation, or simplification of compliance and reporting requirements under the rule for small entities;
3. The use of performance rather than design standards; and

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).

¹⁰³ Letter from Grant Thornton, dated December 27, 2002.

¹⁰⁴ Letter from Lynette Downing, HLB Taugtes 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 is likely with ongoing annual expenses of \$50,000 to \$100,000."

¹⁰⁵ *Id.*

4. An exemption from coverage of the proposed amendments, or any part thereof, for small entities.

The Sarbanes-Oxley Act provides the basis for the requirements and timetables for the record retention rules. The rule is designed to require the retention of those records necessary for oversight of the audit process, to enhance the reliability and credibility of financial statements for all public companies, and to facilitate enforcement of the securities laws.

We considered not applying the proposals to small accounting firms. We believe, however, that investors would benefit if accountants subject to the proposed record retention rules, regardless of their size, audit all companies. We do not believe that it is feasible to further clarify, consolidate, or simplify the proposed rules for small entities.

VII. Codification Update

The "Codification of Financial Reporting Policies" announced in Financial Reporting Release No. 1 (April 15, 1982) is amended as follows:

By amending section 602 to add a new discussion at the end of that section under Financial Reporting Release Number 66 (FR-66) that includes the text in Section II of this release.

The Codification is a separate publication of the Commission. It will not be published in the Code of Federal Regulations.

VIII. Statutory Bases and Text of Amendments

We are adopting amendments to Regulation S-X under the authority set forth in sections 3(a) and 802 of the Sarbanes-Oxley Act, and Schedule A and sections 7, 8, 10, 19 and 28 of the Securities Act, sections 3, 10A, 12, 13, 14, 17, 23 and 36 of the Exchange Act, sections 5, 10, 14 and 20 of the Public Utility Holding Company Act of 1935, sections 8, 30, 31, 32 and 38 of the Investment Company Act of 1940.

List of Subjects in 17 CFR Part 210

Accountants, Accounting.

Text of Amendments

In accordance with the foregoing, Title 17, Chapter II of the Code of Federal Regulations is amended as follows:

1. The authority citation for Part 210 is revised to read as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 77z-2, 77aa(25), 77aa(26), 78j-1, 78l, 78m, 78n, 78o(d), 78u-5, 78w(a), 78ll(d), 79e(b), 79j(a), 79n, 79t(a), 80a-8, 80a-20, 80a-29,

⁹⁸ Letter from PricewaterhouseCoopers dated December 27, 2002.

⁹⁹ 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."

¹⁰⁰ Letter from BDO Seidman, LLP dated December 27, 2002.

¹⁰¹ *Id.*

¹⁰² 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