

partner.¹³⁰ Other commenters,¹³¹ however, believed that extending the rotation requirements beyond the two partners named in the Act could potentially harm audit quality and could impose additional costs on registrants. For example, one commenter¹³² indicated that the proposed rotation requirements would cause the firm to have to rotate 181 partners in 88 countries for one large multi-national client. Another commenter¹³³ estimated that more than 250 partners in 80 countries would be subject to the rotation requirements under the proposed rules. Additionally, some commenters stated that the additional costs that accounting firms would incur to rotate and, in many cases, relocate audit partners would have to be passed on to registrants.

While other commenters¹³⁴ agreed with the concept of extending the partner rotation requirements beyond the two partners named in the Act, they suggested that the final rules should not apply as broadly as the Commission had proposed. One commenter suggested that assessing the “right cut” in identifying partners for rotation was a balance between the responsibility for final decisions on accounting and financial reporting issues affecting the financial statements and the level of the relationship with management.¹³⁵

Commenters¹³⁶ noted that applying the rotation requirements too deeply could threaten the quality of the audit in certain situations. For example, in certain countries there may be a limited pool of audit partners who are familiar with U.S. GAAP and GAAS. In certain “specialty” areas, there may be a limited number of “specialty” partners available

to service the client.¹³⁷ In certain industries there may be limited industry expertise. Also, by applying the rotation requirements more deeply, firms might have a difficult time grooming another partner to both have sufficient knowledge of the industry and the client and have sufficient time remaining prior to rotation when the lead partner or concurring partner must rotate. Also, some commenters¹³⁸ noted that applying the proposed rotation requirements to specialty partners could impact audit quality.

We believe that the partner rotation requirements must strike a balance between the need to achieve a fresh look on the engagement and a need for the audit engagement team to be composed of competent accountants. We believe that a proper balance is one that weighs the responsibility for decisions on accounting and financial reporting issues impacting the financial statements with the level of the relationship with senior management of the client. Such a balancing clearly would include the lead (high on both dimensions) and concurring partners (high on responsibility for final decisions, somewhat lower on level of relationship with management). In addition to that, the lead partner at significant operating units has a high involvement with senior management and, for significant operations, responsibility for decisions on accounting matters that affect the financial statements. Likewise, other audit partners at the parent or issuer have a high involvement with senior management and some responsibility for accounting matters to be included in the financial statements.

In contrast, partners at smaller operating units and “specialty” partners typically have a low level of involvement with senior management and the responsibility for the overall presentation in the financial statements is relatively low.

Nonetheless, the Commission is sensitive to the impact that its proposed rotation requirements would have on audit competence in certain instances as well as costs to registrants. Consistent with this approach, we believe that the proper balance is achieved by extending the partner rotation requirements

beyond the lead and concurring partner but less deeply than we proposed. In response to the concerns of commenters that our proposed rules went too deep, thus imposing significant costs on registrants and accountants as well as creating potential concerns of audit quality, the rules we are adopting will subject a smaller number of partners to the rotation requirement. Accordingly, we are adopting rules that apply the partner rotation requirements to “audit partners” which is a new term defined in these rules.

In addition to the lead and concurring partners, “audit partners” include partners on the audit engagement team who have responsibility for decision-making on significant auditing, accounting, and reporting matters that affect the financial statements or who maintain regular contact with management and the audit committee. In particular, audit partners would include all those who serve the client at the issuer or parent level, other than specialty partners. Further, the lead partner on subsidiaries of the issuer whose assets or revenues constitute 20% or more of the consolidated assets or revenues are included within the definition of “audit partner.”

Thus, the term audit partner does not extend to all partners on the audit engagement team. For example, partners serving on subsidiaries which constitute less than 20% of the assets and revenues of the issuer would not be audit partners as we have defined that term and, thus, would not be subject to rotation. Likewise, partners on subsidiaries above the 20% threshold, other than the lead partner on those subsidiaries, are not subject to rotation.¹³⁹

Audit partners also would exclude “specialty” partners because they typically do not have significant interaction with management on an ongoing basis regarding significant audit, accounting, and reporting matters. It is the lead partner (who is subject to rotation) who has the ultimate responsibility for the audit. We believe that this addresses the concern that many commenters expressed regarding certain “specialty” partners.

We believe that defining the term “audit partners” as the basis for defining those partners who are subject to the rotation requirements is responsive to the concerns expressed by some commenters of the problems that would be created by applying the

¹³⁰ See, e.g., letter from Lynn E. Turner dated January 13, 2003.

¹³¹ See, e.g., letter from Aramark Corporation, dated December 26, 2002; letter from Aetna, Inc., dated January 13, 2003; letter from PricewaterhouseCoopers, dated January 8, 2003; letter from Mellon Financial Corporation, dated January 10, 2003; letter from SAP AG, undated; letter from Chamber of Commerce of the United States of America, dated January 9, 2003; letter from The Business Roundtable, dated January 14, 2003.

¹³² See, letter from PricewaterhouseCoopers dated January 8, 2003.

¹³³ See, letter from HSBC dated January 10, 2003.

¹³⁴ See, e.g., letter from Ernst & Young LLP, dated January 6, 2003; letter from Robert G. Beard, undated; letter from Institute of Chartered Accountants in England and Wales, dated January 10, 2003.

¹³⁵ See, letter from Deloitte & Touche LLP, dated January 10, 2003.

¹³⁶ See, e.g., letter from The Business Roundtable, dated January 14, 2003; PricewaterhouseCoopers, dated January 8, 2003; letter from KPMG, dated January 9, 2003; letter from Philip A. Laskawy, dated January 9, 2003; letter from Pfizer, dated January 13, 2003; letter from Aetna, Inc., dated January 13, 2003.

¹³⁷ Specialty partners are, among others, those partners who consult with others on the audit engagement team during the audit, review or attestation engagement regarding technical or industry-specific issues. For example, such partners would include tax specialist and valuation specialist.

¹³⁸ See, e.g., letter from Ernst & Young LLP, dated January 6, 2003; letter from Deloitte & Touche, dated January 10, 2003.

¹³⁹ A threshold of 20% often has been used in the accounting literature as a basis for “significance” tests. See, e.g., APB Opinion No. 18, “The Equity Method of Accounting for Investments in Common Stock,” and ARB No. 43, Chapter 7, “Capital Accounts.”