

rotation requirements deeper in the firm. Accordingly, we believe that this requirement establishes an appropriate balance between the need for a fresh look with the difficulties encountered in certain locations where the pool of available talent is limited.

In many cases, registrants have complex business transactions and other situations which may require that the engagement team consult with the accounting firm's national office or others on technical issues. Consistent with our proposal, partners assigned to "national office" duties (which can include technical accounting and auditing—whether at a local or national level—as well as centralized quality control functions) who may be consulted on specific accounting issues related to a client are not audit partners even though they may periodically consult on client matters.¹⁴⁰ While these partners play an important role in the audit process, they serve, primarily, as a technical resource for members of the audit team. Because these partners are not involved in the audit *per se* and do not routinely interact or develop relationships with the audit client, we do not believe that it is necessary to rotate the involvement of these personnel.

3. Rotation Period for Partners Other Than the Lead and Concurring Partners

Some commenters¹⁴¹ believed that a different rotation period should be provided to partners other than the lead and concurring partners. In particular, if other partners subject to the rotation requirements had a longer period before they were required to rotate, firms would be better able to establish appropriate transition plans from one lead or concurring partner to the next. The longer rotation period for the other partners would allow them to spend time on the engagement team to learn about the business and the industry before having the ultimate responsibility for the engagement.

In response to these concerns, the rules we are adopting require partners subject to the rotation requirements, other than the lead and concurring partner, to rotate after no more than seven years and to be subject to a two-year time-out. In this way, a partner could serve either as the lead partner on a significant subsidiary or as an "audit partner" at the parent or issuer level for

a period of time (*e.g.*, two years) prior to becoming the lead or concurring partner on the engagement and still be able to serve in that lead or concurring role for five years.¹⁴²

In conducting its oversight review of registered public accounting firms, we expect that the Public Company Accounting Oversight Board ("the Board") will monitor the impact of these rules on audit quality and independence.

4. Small Business/Small Firm Considerations

Many commenters¹⁴³ stated that if the rotation requirements were applied to smaller firms, many smaller firms would be unable to provide audit services to their public clients and would be forced to give up their public clients. Many commenters¹⁴⁴ suggested that this would result in those clients incurring greater costs such as from having to identify a new accounting firm, from the need to familiarize accountants with the client firm's industry and business practices and from the resulting reduction in competition among firms.¹⁴⁵ As we noted in the proposal, we are sensitive to the impact of our rules on smaller business and smaller firms.

Commenters¹⁴⁶ made a number of suggestions about how to accommodate the needs of smaller issuers and smaller firms including: (1) Exempting the firms

¹⁴² An audit partner who starts in a position other than the lead or concurring partner and subsequently moves to the lead or concurring partner cannot serve the client in an audit partner capacity for more than seven consecutive years. For example, a person serving as the lead partner on a significant subsidiary for a period of four years who then becomes the lead partner on the issuer would be able to serve in that capacity for three additional years before reaching a total of seven years as an audit partner on that client.

¹⁴³ See, *e.g.*, letter from Piercy, Bowler, Taylor & Kern, dated January 7, 2003; letter from Witt, Mares & Company PLC, dated January 11, 2003; letter from Burton, McCumber & Cortez LLP, dated January 2, 2003; letter from American Institute of Certified Public Accountants, dated January 9, 2003; letter from Spence, Marston, Bunch, Morris & Co., dated January 13, 2003; letter from The Business Roundtable, dated January 14, 2003.

¹⁴⁴ See, *e.g.*, letter from Weaver & Martin LLC, dated December 31, 2002; letter from CPA Associates, dated January 3, 2003; letter from Symonds, Evans & Company PC, dated December 19, 2002.

¹⁴⁵ See, *e.g.*, letter from U.S. Small Business Administration's Office of Advocacy, January 13, 2003. We note that the GAO also is conducting a study on the consolidation in the accounting industry as directed by Section 701 of the Sarbanes-Oxley Act.

¹⁴⁶ See, *e.g.*, letter from Castaing, Hussey & Lolan LLC, dated January 10, 2003; letter from Piercy, Bowler, Taylor & Kern, dated January 7, 2003; letter from Trice, Geary & Myers LLC, dated January 13, 2003; letter from Smith, Carney & Co., dated January 7, 2003; letter from Crammore, FitzGerald & Meaney, dated December 27, 2002.

based on criteria such as number of partners, number of SEC clients, firm revenue, or number of professional personnel and (2) exempting accountants of smaller issuers as measured by revenue, assets, market capitalization, or profitability.

The existing professional standards on partner rotation contain an exemption for firms with fewer than five audit clients and fewer than ten partners.¹⁴⁷ We recognize the need to consider the impact of our rules on smaller businesses and smaller firms. While we believe it is appropriate to codify that exemption, we remain concerned about the quality of audits of all registrants. Accordingly, in order for audit firms with fewer than five audit clients that are issuers¹⁴⁸ and fewer than ten partners to qualify for the exemption from partner rotation, the Board must conduct a review of all of the firm's engagements subject to the rule at least once every three years. This special review should focus on the overall quality of the audit and, in particular, the independence and competence of the key personnel on the audit engagement teams.

5. Investment Companies

Under the proposed rule, a partner performing audit, review, or attestation services for any entity in the investment company complex could only do so if they had not served five consecutive years on any entity in the same investment company complex. The rotation requirement would have extended not only to the audit partners, but also those specialized partners, such as tax partners, that work on significant aspects of the audit. Those partners affected by the rotation requirement would have had to remain completely off any engagements in the investment company complex for a period of five years before they could again audit the investment company.

Commenters¹⁴⁹ raised significant concerns in the application of the proposed rule to investment companies. Two commenters¹⁵⁰ were concerned with the prohibition of partners who had served five consecutive years at a service provider or other non-investment company entity in the

¹⁴⁷ AICPA, SEC Practice Section, Requirements of Members, at item e.

¹⁴⁸ As defined in section 10A(f) of the Securities Exchange Act of 1934 (15 U.S.C. 78j-1(f)).

¹⁴⁹ See, *e.g.*, letter from Deloitte & Touche, dated January 10, 2003; letter from Putnam Mutual Funds, not dated; letter from The Vanguard Group, dated January 13, 2003; letter from PricewaterhouseCoopers, dated January 8, 2003.

¹⁵⁰ See, letter from PricewaterhouseCoopers, dated January 8, 2003; letter from Investment Company Institute, dated January 13, 2003.

¹⁴⁰ 17 CFR 210.2-01(f)(7).

¹⁴¹ See, *e.g.*, letter from Ernst & Young, dated January 6, 2003; letter from Deloitte & Touche, dated January 10, 2003; letter from KPMG, dated January 9, 2003; letter from Dixon Odom, dated December 20, 2002; letter from The Business Roundtable, dated January 14, 2003.