

investment company complex from serving on the audit of a registered investment company in the same investment company complex without first observing the five year "time out" period.¹⁵¹ One commenter¹⁵² was concerned with the prohibition against partners who had served five consecutive years at an unregistered fund from serving on the audit of a registered investment company in the same investment company complex without first observing the five year "time out" period. One commenter¹⁵³ emphasized the financial reporting personnel and accounting control systems used by investment companies are different from those used for other entities in the investment company complex. As a result, the rotation of an audit partner from a non-registered investment company entity in the investment company complex to a registered investment company would provide a "fresh look" at the accounting control systems and the financial reporting process. In addition, due to the structure of the investment company complex organizations, the rotated partner typically would not be dealing with the same individuals in management or on the audit committee that they might have dealt with previously as the audit partner on an entity in the investment company complex.

We believe that the rotation requirements with regard to investment companies should prohibit the rotation of partners between different investment companies in the same investment company complex. We do not believe, however, that it is necessary for the rule

to prohibit accountants from rotating to other entities in the investment company complex. Consequently, the rule, as adopted, will not allow audit partners to satisfy the partner rotation requirements by rotating between investment companies in the same investment company complex. The individual required to rotate and the applicable periods for rotation and "time-out" from the audit client will be applied in the same manner to investment companies as to other issuers. Lead and concurring partners will be required to rotate after a total of five consecutive years in either role. At a minimum, all audit partners that audit investment companies will be required to rotate after a total of seven years of consecutive service on any of the investment companies in the same investment company complex. Lead and concurring partners will be required to observe a "time out" period for five years before returning to the investment company and all other audit partners will be subject to a two year "time out" period.

The unique structure of investment company complexes allows for many different fiscal year-ends within the same investment company complex. In order to allow a partner to serve the total number of allowable periods on any one investment company audit in the complex, while still requiring partners to rotate off an investment company complex at the end of their specific periods, we have defined consecutive years of service for investment companies. A consecutive year of service for audit partners includes all fiscal year-end audits of investment companies in the same investment company complex that are performed in a continuous 12-month period. This would allow audit partners auditing multiple investment companies in the same investment company complex to audit each investment company for five or seven complete fiscal years, as appropriate.

6. Effective Date and Transition

In order to allow firms to establish an orderly transition of their audit engagement teams, the Commission is establishing transition provisions related to the partner rotation requirements. Since the lead partner was previously subject to rotation requirements, these rotation requirements should not impose a significant incremental burden on accounting firms. Accordingly, the rotation requirements applicable to the lead partner are effective for the first fiscal year ending after the effective date of these rules. Furthermore, in

determining when the lead partner must rotate, time served in the capacity of lead partner prior to the effective date of these rules is included. For example, for a lead partner serving a calendar year audit client, if 2003 was that partner's fifth, sixth or seventh year as lead partner for that audit client, he or she would be able to complete the current year's audit and he or she must rotate off for the 2004 engagement.

The other partners subject to these rotation requirements were not previously subject to rotation. Accordingly, we believe that some additional transition is needed for these partners. In order to maintain continuity on the engagement, firms will need to stagger the rotation of partners. This is especially critical for the lead and concurring partners. As a consequence, to facilitate the process of staggering the rotation of the lead and concurring partners, the rotation requirements for the concurring partner are effective as of the end of the second fiscal year after the effective date of the rules. Therefore, a concurring partner for a calendar year audit client for which 2003 was his or her fourth or greater year in that role,¹⁵⁴ he or she would be able to serve in that capacity for the 2004 audit before being subject to rotation.

Since the other partners covered by these rules were neither identified in the Act nor previously subject to rotation requirements, we believe, consistent with many commenters, that a longer transition period is warranted. Accordingly, for other partners, the rules are effective as of the beginning of the first fiscal year after the effective date of these rules. However, in determining the time served, that first fiscal year will constitute the first year of service for such partners. For example, for a lead partner on a significant subsidiary with a calendar year reporting period, 2004 would constitute the first year in the seven year rotation period, regardless of how many years he or she had previously served in that capacity.

Finally, we recognize that in many foreign jurisdictions partners previously were not subject to rotation requirements. Accordingly, for all partners with foreign accounting firms who are subject to rotation requirements, the rules are effective as of the beginning of the first fiscal year after the effective date of these rules. Likewise, in determining the time served, that first fiscal year will

¹⁵¹ Commenters also were concerned with the availability of competent audit, tax and other specialized partners to effectively rotate between the investment company audits. One commenter indicated tax partners typically served a far greater number of investment company audit clients per partner than their counterparts in the other industry practices (*see*, letter from Investment Company Institute, dated January 13, 2003). Commenters were concerned that lack of depth in this industry would ultimately reduce audit quality and harm investors (*see, e.g.*, letter from Putnam Mutual Funds, not dated). Commenters also were concerned with the depth of audit resources in certain markets (*see, e.g.*, letter from Oppenheimer Funds, Inc., dated January 13, 2003). One commenter indicated the proposed rule would effectively bar them from performing audits of investment companies (*see*, letter from McCurdy & Associates, CPAs, Inc., dated December 12, 2002). We have addressed these concerns by the changes to the partner rotation requirements that impact all issuers in addition to registered investment companies.

¹⁵² *See*, letter from PricewaterhouseCoopers, dated January 8, 2003.

¹⁵³ *See*, letter from PricewaterhouseCoopers, dated January 8, 2003. *See, also*, letter from Investment Company Institute, dated January 6, 2003.

¹⁵⁴ Since concurring partners were not previously subject to rotation requirements, it is quite likely that many partners will have served in significantly more than five years in that capacity at the time of transition.