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HRO Alert

The Sarbanes-Oxley Act of 2002

Final Rules:

RETENTION OF RECORDS RELEVANT TO AUDITS AND REVIEWS

On January 24, 2003, the SEC released final rules relating to auditors' retention of records relevant to audits and reviews. These rules, required under the Sarbanes-Oxley Act of 2002 (the "SO Act"), finalize and, in some cases, revise the SEC's proposed rules relating to retention of audit documents and records, which were released on November 21, 2002.

This HRO Alert summarizes the main provisions of the final rules. These rules apply to audits and reviews completed for any U.S. public company, foreign private issuer or registered investment company on or after October 31, 2003.

GENERAL RETENTION REQUIREMENT AND RETENTION PERIOD

Pursuant to Section 802 of the SO Act, which directed the SEC to promulgate rules related to retention of records relevant to the audit and review of financial statements companies file with the SEC, the SEC adopted rules adding a new Rule 2-06 to Regulation S-X. Rule 2.06 requires accounting firms to retain documents relevant to the audit and review of financial statements of public companies and registered investment companies for a period of seven years. Initially, the SEC proposed a retention period of only five years, but elected to require a seven-year retention period in the final rules to conform with separate retention rules to be adopted by the Public Company Accounting Oversight Board under Section 103 of the SO Act.

DOCUMENTS TO BE RETAINED

General Retention Requirements

Rule 2.06 requires retention of "records relevant to the audit or review, including 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: (1) are created, sent or received in connection with the audit or review, and (2) contain conclusions, opinions, analyses, or financial data related to the audit or review."

Documents Not Required to Retained

In response to comments, the SEC acknowledged that Rule 2-06 generally was not intended to require retention of the following documents, provided such documents do not contain information or data relating to a significant matter that is inconsistent with the auditor's final conclusions, opinions or analysis on such matter (See "Differences of Opinion" below):

- superseded drafts of memoranda, financial statements or regulatory filings;
- notes on superseded drafts of memoranda, financial statements or regulatory filings that reflect incomplete or preliminary thinking;
- prior copies of workpapers that are limited to corrections for typographical errors or training of new employees;
- duplicates of documents; or
- voice-mail messages.

Furthermore, the SEC responded to commenters' concerns that the term "received" might require an auditor to retain all financial information, databases, records and reports that the auditor reviews at the company's premises, but are not otherwise made part of the auditor's

workpapers. It was not Congress' intent, the SEC concluded, to require an auditor to duplicate and retain all documents and records reviewed on the company's premises if such documents or records are not made part of the auditor's workpapers.

Workpapers

Rule 2.06 defines "workpapers" as "documentation of auditing or review procedures applied, evidence obtained, and conclusions reached by the accountant in the audit or review engagement, as required by standards established or adopted by the [SEC] or by the Public Company Accounting Oversight Board." The SEC noted that its definition of "workpapers" is intended to include those documents generally understood to be required to be retained under generally accepted auditing standards.

DIFFERENCES OF OPINION

Under the proposed rules, the SEC would have required retention of the documents described under the heading "General Retention Requirement" even if such documents would "cast doubt on the final conclusion reached by the auditor." (emphasis added) The SEC received significant comments to the "cast doubt" language included in the proposed rules. Such comments raised the concern that the "cast doubt" standard may deter auditors from asking legitimate questions and the observations that such language would require retention of documents that simply represent on-the-job training or "fleeting and trivial differences" between accountants.

In response to these comments, the SEC revised the final rules to require retention of documents described under "General Retention Requirement" above "whether they support the auditor's final conclusions or contain information or data, relating to a significant matter, that is inconsistent with the auditor's final conclusions regarding that matter or the audit or review." Rule 2.06 states that the significance of a matter requires an objective analysis of the facts and circumstances. The SEC expanded on the concept of a "significant" matter by explaining it relates to "documentation of substantive matters that are important to the audit review process or to the financial statements" of the company. Finally, Rule 2-06 provides that documents and records of the type described in this paragraph include, but are not limited to, "those documenting consultations on or resolutions of differences in professional judgment." Acknowledging the interactive nature of the audit or review process, the SEC instructed that changes in preliminary views or assessments of an auditor as a result of incomplete information or data do not rise to the level of "differences in professional judgment."

HOW HRO CAN HELP

The rules described in this HRO Alert will generally have the most significant impact on your company's auditor. If you would like to discuss these rules and how they may affect your company, we encourage you to contact any of the persons listed in the margin of the first page of this HRO Alert.

This HRO Alert is a periodic publication of Holme Roberts & Owen LLP and should not be construed as legal advice or legal opinion on any specific facts or circumstances. Nor is it intended to address specific compliance issues that may arise in particular circumstances or all of the provisions included in the newly adopted rules. The contents are intended for general informational purposes only, and you are urged to consult counsel concerning your own situation and any specific legal questions you may have. For further information regarding the rules described herein, please contact any of the persons listed in the margin of the first page of this HRO Alert.

2/14/03

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