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February 23, 2007

Securities and Exchange Commission
Attn: Nancy M. Morris, Secretary
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: **File Number S7-24-06**
Proposed interpretive guidance for management regarding its evaluation of internal control over financial reporting

Dear Ms. Morris:

Deloitte & Touche LLP is pleased to respond to the request for comments from the Securities and Exchange Commission (the "Commission" or the "SEC") with respect to its proposed rules and interpretive guidance for management regarding its evaluation of internal control over financial reporting [Release No. 33-8762; 34-54976; File No. S7-24-06]. We hope our comments will provide helpful insights about improving the effectiveness and efficiency of conducting an assessment of internal control over financial reporting (hereinafter ICFR). The comments provided herein are based on our collective insights and experiences in performing integrated audits and also reflect insights from the non-U.S. member firms of Deloitte Touche Tohmatsu.

I. Introduction

We support the overall direction of the recent proposals by the Commission related to the implementation of Section 404 of the Sarbanes-Oxley Act of 2002. The requirement in Section 404 that both management and the independent auditor report on the effectiveness of a company's ICFR has improved disclosures to investors about internal control-related matters, enhanced the reliability of financial statements, and placed a stronger focus on management's responsibilities regarding the establishment and maintenance of effective ICFR. Providing principles-based interpretive guidance for management will be useful in guiding its overall process to assess the effectiveness of ICFR as required by Section 404.

II. General Comments

Below we address several key concepts within the Commission's guidance for which we would like to specifically express our support.

First, we support the Commission's commitment to a single, scalable requirement for management's ICFR assessment and disclosure and for auditor attestation. A system whereby different rules apply to issuers of different sizes would be very difficult for investors to understand, and we believe such a system would result in much confusion. Moreover, only a truly scalable system is consistent with a principles-based and top-down, risk-based approach to assessing ICFR. A tiered system with different

requirements for various categories of issuers based on bright-line rules, such as company size (as has been suggested by some commentators), constrains the use of judgment in favor of artificial criteria. A single, scalable system, on the other hand, is consistent with the use of judgment by management and auditors in considering the risks and circumstances of each company, based on its nature and complexity.

For example, in designing an assessment of ICFR under a scalable system, management and the auditor of any sized company can consider the complexity and risk of the company's business, including its span of operations, its degree of decentralization, its control systems, its management structure and commitment to controls, the experience, qualifications, and number of its financial personnel, its reliance on automated or manual controls, and the simplicity or complexity of the transactions it enters into and the related accounting and reporting requirements. In short, a single, scalable system allows all companies to take advantage of efficiencies that can result from their individual circumstances, regardless of their size. The proposal put forth by the SEC helps achieve this goal of a scalable system by: 1) providing principles-level guidance that allows management to use its judgment; 2) focusing on a risk-based approach to testing and evaluating ICFR; 3) emphasizing the importance of effective entity-level controls; 4) pointing out that management does not have to identify and evaluate all controls that exist and that management only needs to evaluate those general IT controls that are necessary to adequately address financial reporting risks; and 5) using the degree of complexity, risk, and level of judgment involved in performing a control to determine the nature and extent of supporting evidential matter necessary for its assessment.

Second, we agree with the requirement in the proposed guidance for management to test on a yearly basis the operating effectiveness of ICFR. Management testing of operating effectiveness is essential to provide investors with information about whether the controls in place at a company actually work. Additionally, we agree with the requirement that every public company be subject to an annual audit of ICFR and that such requirement is in the best interest of investors. Alternatives based on limiting the scope of the auditor's work, such as reporting only on design and implementation of internal control (and thus not testing for operating effectiveness) would substantially decrease the benefits to investors. A scalable, top-down, risked-based approach that includes evaluating the operating effectiveness of ICFR by management and independently by the auditor will lead to effective and efficient assessments of ICFR that appropriately serve the interests and needs of investors.

Finally, we support efforts to improve the effectiveness and efficiency of the Section 404 assessment process (including both management's assessment and the integrated audit) while at the same time maintaining quality and providing valuable information to investors. We believe the steps underway to provide principles-based guidance to management and to replace the Public Company Accounting Oversight Board's ("PCAOB") Auditing Standard No. 2 with a new auditing standard (both endorsing a scalable risk-based approach and allowing both management and auditors to use more judgment) will achieve the goal of making the Section 404 process more cost-effective. Experience in the last several years indicates that costs associated with the Section 404 process have declined significantly from the first year of implementation and continue to decline. For example, various studies and surveys have shown that there have been significant reductions in overall Section 404 costs (internal costs, third party costs, as well as external audit fees) in the second year of implementation for accelerated filers.[1]

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[1] The Sarbanes-Oxley Section 404 Costs and Implementation Issues: Spring 2006 Survey Update by CRA International states that total 404 costs declined significantly in year 2 of implementation, falling 30.7 percent for Smaller Companies and 43.9 percent for Larger Companies. Additionally, results of the March 2006 FEI Survey

We believe that the combined efforts underway at the SEC and PCAOB (including the proposed new standard to replace AS No. 2 and the work being done to develop guidance for conducting audits of internal control of smaller public companies), as well as other efforts by the Committee of Sponsoring Organizations ("COSO") will support additional improvements in the Section 404 process and provide additional opportunities to reduce costs (both internal and external) of complying with the requirements. Additionally, we believe these efforts will help companies, including non-accelerated filers that have not yet implemented Section 404, achieve benefits from knowledge gained and better manage the costs and efforts expended in the initial years of compliance with Section 404. We also believe that the proposed guidance provides companies that are already subject to Section 404 with an opportunity to reassess and improve the efficiency of their current processes.

Specifically, we expect the SEC's proposed management guidance, along with the proposals by the PCAOB, will result in a reduction of total Section 404 efforts and costs, due to various specific, positive aspects of the proposals. These would include (a) the ability of management to undertake a controls rationalization process and to focus its assessment on those controls that impact its financial statement reporting, (b) the ability of an auditor to adjust and scale the nature, timing and extent of audit work, based on the size and complexity of an issuer's operations, and c) the ability of an auditor to increase the extent of the use of the work of others, if certain conditions are met.

It is likely that the benefits achieved by companies will vary significantly based on the facts and circumstances for each particular company, the state of the ICFR within each company, and the extent to which management already has effective ICFR in place. Therefore, although we believe greater efficiency will be achieved as a result of the proposals by the Commission and the PCAOB, specific percentage reductions or constant reductions in total Section 404-related costs for all companies may not be reasonable goals.

We also believe that opportunities for efficiency and effectiveness in the Section 404 process can be realized if the auditor uses management's work to the maximum extent permitted under the standards. While management's assessment of ICFR and the audit of ICFR are separate activities and need not be conducted in the same manner, there is important interaction between the two through the auditor's consideration of the work of others and the ability of the auditor to use the company's documentation as evidential matter to support the auditor's opinion. As a result, the manner in which management conducts its assessment, the competence and objectivity of those testing ICFR, and the documentation available to support that assessment directly impacts the potential efficiency of the audit process.[2]

As discussed above, we are supportive of the Commission's proposal; however, based on our analysis of the proposed guidance, we do have some specific comments in response to the Commission's questions, which are discussed in the attached Appendix.

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on SOX Section 404 Implementation indicates that the total average cost for Section 404 compliance was $3.8 million during fiscal year 2005, down 16.3 percent from 2004.

[2] It is also important to note that there are other significant factors that impact audit costs besides costs associated with assessing ICFR. These include additional audit procedures and documentation requirements based on other new accounting and auditing standards, increased demand and intense competition for accounting and auditing resources, increased compliance and regulatory requirements for auditors, practice protection costs, and litigation.

We appreciate the opportunity to comment on the Commission's proposed interpretive guidance for management. The issues presented here are complex and may warrant further discussion to fully understand the implications of particular comments made by us and other commenters. As such, we would suggest that the SEC engage in active dialogue with issuers and auditors as comments on the proposals are evaluated and changes to the proposed guidance are considered. Such a dialogue will facilitate complete understanding of the comments on the proposals, assist in the consideration of related implications and likely results, and ultimately improve the implementation of the final guidance. We would welcome the opportunity to further discuss these issues with the staff and the Commission. If you have any questions or would like to discuss these issues, please contact Robert Kueppers at (212) 492-4241, James Schnurr at (203) 761-3539, or John Fogarty at (203) 761-3227.

Very truly yours,

/s/ Deloitte & Touche LLP

cc: Chairman Christopher Cox
Commissioner Paul Atkins
Commissioner Roel Campos
Commissioner Annette Nazareth
Commissioner Kathleen Casey
Conrad Hewitt, Chief Accountant
John White, Director, Division of Corporation Finance
Zoe-Vonna Palmrose, Deputy Chief Accountant for Professional Practice

Mark W. Olson, Chairman of the PCAOB
Kayla J. Gillan, Member
Daniel L. Goelzer, Member
Bill Gradison, Member
Charles D. Niemeier, Member
Thomas Ray, Chief Auditor and Director of Professional Standards

APPENDIX
Responses to Questions Posed by the Commission

1. ***Will the proposed interpretive guidance be helpful to management in completing its annual evaluation process? Does the proposed guidance allow for management to conduct an efficient and effective evaluation? If not, why not?***

   We believe the interpretive guidance that has been proposed by the Commission achieves the objective of being both scalable and principles-based. As discussed in our General Comments section of this letter, we believe a scalable, top-down, risked-based approach that includes testing operating effectiveness of ICFR is in the best interest of investors and will lead to an efficient and effective assessment of ICFR. The proposal put forth by the SEC helps achieve this goal of a scalable system, and for many large and/or sophisticated companies, this principles-based guidance will be sufficient in helping management complete its annual evaluation process. Additionally, we believe that the flexibility provided will allow for management to conduct its evaluation in an efficient and effective manner.

   We also believe successful implementation of Section 404 by smaller companies will likely be dependent upon and necessitate additional detailed application guidance regarding the annual evaluation process. COSO's *Internal Control Over Financial Reporting Guidance for Smaller Public Companies* will be useful in this regard as it provides application guidance related to the evaluation of ICFR. Also, the recently initiated COSO project to develop additional application guidance on monitoring, including tools and techniques may provide further guidance that smaller companies will find useful in planning and performing their assessments. Therefore, as the guidance from the SEC is on a principles-based level, we believe it would be helpful for the SEC to acknowledge and reaffirm that the use of the COSO materials (and other appropriate materials that might be available by other developers of control frameworks) may be helpful and, indeed, are acceptable resources.

2. ***Are there particular areas within the proposed interpretive guidance where further clarification is needed? If yes, what clarification is necessary?***

   Below we describe the areas of the Commission's proposed guidance that we believe need further clarification.

   <u>*Consideration of fraud risks*</u>
   We recognize that the proposed guidance in Section A.1.a. states that management's evaluation of financial reporting risks should also consider the vulnerability of the entity to fraudulent activity and whether any of those exposures could result in a material misstatement of the financial statements. Due to the importance of management's consideration of fraud in the context of identifying financial reporting risks, we believe this point should have more emphasis and further elaboration in the SEC's final guidance. In particular, it should be stressed that the risk of material misstatement due to fraud exists in most, if not all, companies. Further the guidance should discuss the point that identifying fraud risk does not necessarily mean that a fraud or misstatement has occurred; rather, it means that there is a risk that a material misstatement due to fraud could occur. In addition to adding these points, we believe the importance of focusing on fraud risk should be mentioned throughout the management guidance.

Entity-level controls
We believe that the proposed guidance properly describes the nature of entity-level controls. In particular, the guidance appropriately recognizes that certain entity-level controls are designed to operate at the process, transaction, or application level and might adequately prevent or detect on a timely basis material misstatements in one or more financial reporting elements that could result in a material misstatement to the financial statements. Additionally, we also support the parameter included in the proposed guidance that some entity-level controls, such as the control environment, are indirectly related to a financial reporting element and may not, by themselves, be effective at preventing or detecting a misstatement in a financial reporting element that could result in a material misstatement to the financial statements. However, we recommend that the guidance include additional parameters on the level of precision of entity-level controls necessary to address the risk of material misstatement for a given financial reporting risk. For example, the proposed guidance should more specifically recognize that, in order to appropriately address the risk of misstatement, entity-level controls must operate at a level of precision that would detect misstatements that are less than material to the financial statements, in order to appropriately consider aggregation risk.

By way of illustration, if there are many entity-level detective controls in a company with a large number of business units, and such controls are designed to detect only material misstatements, the risk of misstatement for any given risk addressed by these controls would not be properly addressed because of the strong likelihood that the misstatements not detected by these controls could aggregate to an amount in excess of what would be considered material to the financial statements. As such, we believe the guidance needs to recognize that, to appropriately address the risk of misstatement for a given financial reporting risk, entity-level controls need to operate at a level of precision that would detect misstatements that are less than material to the financial statements in order to appropriately consider aggregation risk.

We also recommend the guidance address the consideration of entity-level controls when identifying controls to address the risk of material misstatement due to fraud; in particular, the guidance should address whether an entity-level control can, by itself, address such a risk, and if so, what the characteristics of such a control would need to be (including the degree of precision with which the control needs to be designed to operate).

Financial reporting risks
We agree with the concepts contained within section A.1.a. of the proposed guidance for identifying financial reporting risks. However, we also believe it would be helpful if this section, in describing how to identify financial reporting risks, also described the process as evaluating what could go wrong with the financial statements (i.e., how could material misstatements occur and not be prevented or detected). Additionally, we believe that this section should discuss the importance of evaluating what could go wrong particularly for those line items in the financial statements that have a large balance. As currently drafted, we believe management might interpret the guidance to mean that it may be considered appropriate to exclude from further consideration the controls over large balance financial statement line items considered to have a low risk of misstatement. We believe that excluding large balance financial statement line items from management's ICFR assessment process would pose a significant risk to the quality and completeness of management's assessment and as a result not meet the expectations of investors. Large balance financial statement line items, due purely to their size, have an inherent risk of material misstatement. It is often argued that large balance financial statement line items can be excluded from management's assessment because they are well controlled; however, the lack of

control risk does not address the inherent risk associated with these financial statement line items. Therefore, the controls relating to these large balance financial statement line items should be included within the scope of management's assessment and then, based on the assessed level of control risk, management should plan the nature, timing, and extent of its procedures to assess the design and test the operating effectiveness of relevant controls. If the assessed level of control risk is low, then it may be appropriate to limit the nature and extent of procedures on these accounts, but excluding them altogether is not the appropriate approach for management's assessment of ICFR.

Control framework

We believe the guidance should include additional focus on the evaluation of the design and operating effectiveness of controls within all components of the chosen control framework. Currently, by following the guidance in Section A.1.b, it is possible that a company would identify only those controls at the process level that address the identified financial reporting risks and that management would not perform any evaluation of those entity-level controls that are not specifically identified as addressing financial reporting risks, but nonetheless are important to effective ICFR. Based on the guidance as proposed, we believe there is a risk that companies will underemphasize the significance of the controls related to the control environment, the risk assessment process, the period-end financial reporting process, as well as the evaluation of the risk of fraud, including the risk of management override of controls. In order to ensure these elements are incorporated within management's assessment process, additional language should be added to the guidance highlighting the need for management's assessment to encompass controls that relate to all components of the chosen control framework. Although there is limited discussion of maintaining evidential matter regarding entity-wide and other pervasive elements of ICFR in Section A.1.e, we believe both Sections A.1.b and A.1.c should include a discussion of these areas of ICFR.

Management's ICFR conclusion

We believe the SEC rules that require management to conclude definitively whether or not ICFR is effective and that preclude management from concluding that ICFR is effective if management identifies a material weakness, are appropriate.[3] Additionally, the Staff's Frequently Asked Questions on Management's Report on ICFR and Disclosure in Exchange Act Reporting provides that "management may not state that the registrant's controls and procedures are effective except to the extent that certain problems have been identified or express similar qualified conclusions" but that management may state that controls are ineffective for specific reasons.

However, section B.2. of the proposed guidance seems to go further by providing that management can "state that controls are ineffective due solely to, and only to the extent of, the identified material weakness(es). Prior to making this statement, however, management should consider the nature and pervasiveness of the material weakness." We are concerned that a reporting framework that does not permit an "effective except for" conclusion on ICFR, but which at the same time permits an "ineffective due solely to and only to the extent of" conclusion, will be confusing and easily misunderstood by investors. As such, if the SEC moves to permit an "ineffective due solely to and only to the extent of" conclusion, we believe consideration of the nature and pervasiveness of the material weakness is important, and we believe specific disclosure of this consideration is appropriate. For example, if management determines that ICFR is ineffective due to a pervasive material weakness (such as an ineffective audit committee or lack of

[3] See Regulation S-K, Item 308(a)(3)(17 CFR 229.308)

sufficiently competent personnel), a simple statement that controls are ineffective solely due to that pervasive material weakness may not appropriately convey to investors the significance of the potential impact on ICFR and the pervasiveness of the potential impact on the financial statements. Therefore, we recommend that the Commission provide explicit guidance to management about the disclosure it expects if management finds its controls ineffective "due solely to and only to the extent of" a pervasive material weakness in ICFR.

Management's scope

We recognize that the SEC has explained that the definition of material weakness (and the reference to interim financial statements within the definition) is meant to be used in evaluating deficiencies and not in establishing the scope of management's assessment. However, the proposed guidance may be misinterpreted by some as requiring the scope of the annual assessment to be based on interim materiality due to the stated objective of an ICFR assessment (to identify material weaknesses) and the inclusion of references to both interim and annual financial statements in the definition of material weakness. We believe the SEC's intent that the scope of management's ICFR assessment be established based on what is considered material to the annual financial statements can be clarified by removing the reference to interim financial statements from the definitions of significant deficiency and material weakness. We believe that this change is consistent with establishing the scope of management's ICFR assessment using an annual measure of materiality and reporting on the effectiveness of ICFR as of the end of each annual period.

Despite this change in the definition however, the impact of control deficiencies that materially impact interim reporting but not annual reporting, are and should be a consideration for management in evaluating on a quarterly basis, the effectiveness of disclosure controls and procedures and the required quarterly disclosures about material changes in internal control in financial reporting, (i.e., including control deficiencies that materially affect or are reasonably likely to affect the entity's ICFR, as well as the subsequent remediation of these deficiencies). Through these disclosures investors would be made aware of the existence of deficiencies that materially affect interim reporting and also when management has taken action to remediate them.

Further, the inclusion of the reference to interim financial statements in the definitions of significant deficiency and material weakness currently drives an additional level of effort for issuers and auditors alike in the evaluation of deficiencies. The determination of materiality for quarterly reporting periods continues to present a major challenge for company management and auditors alike. In practice, materiality for quarterly reporting periods, including quarterly periods within previously issued annual financial statements, is often the subject of significant debate among management, auditors and audit committees and there are widely differing views. The lack of guidance on this subject has posed a particular challenge in the implementation of AS No. 2, because the assessment of whether a significant deficiency represents a material weakness depends on the potential impact of the deficiency on both interim and annual periods. We believe that this confusion and frustration would continue under the proposed standard absent further guidance from the SEC staff or others on what is considered material to interim financial statements.

3. ***Are there aspects of management's annual evaluation process that have not been addressed by the proposed interpretive guidance that commenters believe should be addressed by the Commission? If so, what are those areas and what type of guidance would be beneficial?***

We believe two additional areas related to management's ICFR evaluation should be addressed in the interpretive guidance.

First, one area that is not addressed, but which is directly related to performing internal control assessments, is how the annual assessment of internal control over financial reporting relates to the quarterly certifications under Section 302 regarding to the effectiveness of disclosure controls and procedures. Additional guidance in this area is needed with respect to the interrelationship between disclosure controls and procedures and internal control over financial reporting and how a conclusion that internal control over financial reporting is ineffective impacts the conclusion about the effectiveness of disclosure controls and procedures (including the circumstances, if any, in which management might conclude that disclosure controls and procedures are effective, notwithstanding the existence of one or more material weaknesses in internal control over financial reporting).

We also believe it would be helpful to provide guidance to management as to the extent of work required (prior to filing the Form 10-K) after it becomes apparent that a company has a significant number of pervasive material weaknesses. For instance, we believe there are certain fundamental aspects of ICFR such as the control environment (including competency of accounting personnel), the risk assessment process, and segregation of duties; we also believe if it becomes apparent that fundamental aspects of ICFR are pervasively defective, it is appropriate for management to focus on remediating the pervasive deficiencies and making progress on the fundamental aspects ICFR, rather than spending efforts on evaluating all identified controls that address the financial reporting risks. We believe the effort, time, and expense that would otherwise be required to complete the ICFR evaluation process would be better spent remediating the identified pervasive weaknesses and preparing to be in a position to comply with the requirements as soon as possible. Following this approach, management would focus its efforts on making continuous progress on the state of ICFR. In such situations appropriate disclosures could be made by management in its quarterly and annual filings as to the extent and severity of the material weaknesses identified, the remediation activities taking place, and rationale for not completing the evaluation of all identified controls that address the financial reporting risks. We believe that such an approach would be appropriate under certain circumstances and, additionally, may reduce cost burdens associated with Section 404 when fundamental aspects of ICFR are deficient and the conclusion regarding the effectiveness of internal control is readily apparent based on the severity of material weaknesses identified at the outset or during the process.

6. ***Considering the PCAOB's proposed new auditing standards, An Audit of Internal Control Over Financial Reporting that is Integrated with an Audit of Financial Statements and Considering and Using the Work of Others In an Audit, are there any areas of incompatibility that limit the effectiveness or efficiency of an evaluation conducted in accordance with the proposed guidance? If so, what are those areas and how would you propose to resolve the incompatibility?***

Although we are supportive of the overall direction of both the Commission's and the PCAOB's proposals, we believe there are certain differences that may in fact limit the effectiveness and efficiency of performing an evaluation of ICFR. While we agree that management's assessment and evaluation of ICFR and the auditor's audit of ICFR are two separate activities, there is important interaction between the two. As a result, differences can cause inefficiencies in the Section 404 process. To avoid these inefficiencies, we believe the following should be addressed:

Management documentation
We recognize that the SEC intends to provide principles-based guidance and avoid specific prescriptive documentation requirements for management. Irrespective of whether management conducts an ICFR assessment or whether an audit of ICFR is performed, documentation of business processes and internal controls promotes consistency in adhering to desired practices, assists in training new personnel, and helps to communicate what has to be done and how to support the financial reporting process. Additionally, documentation of this nature helps management control and monitor the operations of the business.

We believe that to have effective ICFR, management should have some documentation of the identified financial reporting risks, the roles and responsibilities of company personnel performing internal control functions, and a description of the controls sufficient to communicate how they are to be performed.

To assist companies in performing an effective and efficient ICFR assessment, we believe management should document the financial reporting risks identified, a description of the controls that address those risks, and how the identified controls address the identified financial reporting risks. Also, management should document its conclusion on each of the identified deficiencies and the overall result of its assessment.

Management documentation that may impact the extent to which the auditor is able to use management's work, in addition to the documentation described above, includes (1) documentation of the flow of transactions for each of the company's significant processes and (2) documentation of separate evaluations performed in support of its assessment and the results of those evaluations.

The nature and extent of management's documentation should be based on what is appropriate for the situation. For companies with uncomplicated structures and processes, such documentation may be very simple and short. For larger, more complex companies, documentation will likely be more extensive. However, effective documentation need not be lengthy or complex.

See further discussion regarding management documentation and interaction with the audit process in the response to question 20 below.

Strong indicators of a material weakness
The proposed management guidance and the proposed revision to AS No. 2 differ on what is considered a strong indicator of a material weakness. Specifically, the SEC guidance does not include as a strong indicator of a material weakness the circumstance of an ineffective risk assessment process or internal audit function at companies for which such a function needs to be effective for the company to have an effective ICFR, such as for very large or highly complex companies. With respect to an effective internal audit function, because not all companies have internal audit functions, we can understand not including an effective internal audit function among the list of strong indicators of a material weakness. However, because of the critical role of the risk assessment process within the SEC's proposed management guidance (in identifying financial reporting risks and controls) and because the risk assessment process is a primary component of internal control, we believe the lack of a risk assessment process or an ineffective risk assessment process should be considered a material weakness. To make it clear that this is the case, we suggest the SEC guidance regarding strong indicators of material weaknesses be revised to include an ineffective risk assessment process. Alternatively, it should be explicitly stated that

the lack of a risk assessment process or an ineffective risk assessment process is a material weakness. Different guidance for management and auditors with respect to evaluating deficiencies will result in confusion for management and auditors and will likely create inefficiencies in both management's process and the auditor's process for concluding on the effectiveness of ICFR.

Inconsistencies in reporting
The SEC's proposed guidance provides that the restatement of financial statements does not, by itself, necessitate that management consider the effect of the restatement on the company's prior conclusion related to the effectiveness of ICFR. However, when prior financial statements are being restated, the auditor is required under PCAOB standards to consider whether the restatement results in a material weakness and if so, modify and reissue its auditor's report on ICFR for the material weakness.

Requiring an auditor to re-evaluate its opinion, while at the same time permitting management's prior report on ICFR to remain unchanged without notice to investors that such report should not be relied upon is confusing for investors. For example, if an investor reads a company's amended Form 10-K/A and finds an adverse opinion by the auditor with respect to ICFR but management's report from the original Form 10-K is not changed, investors will be confused. Additionally, this difference between management's requirement and the auditor's requirement creates additional work and inefficiencies at a critical time in the reporting process. To better serve investors, we recommend that under these circumstances, when a restatement of the financial statements is required and it is determined that a material weakness existed as of the date of management's previous report on ICFR, the Commission require the company to amend its most recent ICFR report in its Form 10-K/A to disclose the impact of the restatement on the prior conclusion with respect to ICFR. If no amendment to the prior Form 10-K is necessary, the company should include disclosure of the impact in its Form 10-K for the most recently completed fiscal year. We believe this is the best approach to ensure investors have the most up-to-date information and that investors do not rely upon an out-dated and incorrect conclusion with respect to the effectiveness of ICFR.

7. Are there any definitions included in the proposed interpretive guidance that are confusing or inappropriate and how would you change the definitions so identified?

We agree that management and the auditors need not follow the same process in their respective assessments of ICFR. We also recognize that, perhaps to underscore the differences that can exist in the respective evaluations, the SEC has chosen to use different terminology for management's assessment purposes than what is used in the PCAOB's proposed auditing standard (for example using "financial statement elements" and "financial reporting risks" rather than using "significant account" and "relevant assertion"). While we support principle-based guidance, it is important for management and the auditor to understand how each is applying the respective relevant terms so that inefficiencies in the process are avoided, or at least the reasons for any inefficiency are acknowledged. To avoid inefficiencies, the interpretive guidance should provide further illustrations of what should be considered financial reporting risks for financial statement elements. For instance, we think it would be helpful to explain financial reporting risks as an analysis of what could go wrong with the financial statements and to explain that such an analysis should be performed with respect to each financial statement line item that is qualitatively or quantitatively significant. We believe adding these explanations will make the process more easily understood by all and will help management and the auditor conduct their work in a coordinated manner to achieve desired efficiencies.

10. Are there any considerations unique to the evaluation of ICFR by a foreign private issuer (FPI) that should be addressed in the guidance? If yes, what are they?

As described in our comments in response to the Concept Release, we believe management guidance should clarify certain FPI issues as follows: 1) which financial statements should be used to determine the scope of the assessment of ICFR; and 2) whether FPIs are required to evaluate controls over interim financial reporting and whether the evaluation of deficiencies should include consideration of the impact of the potential misstatement on interim financial statements.

We are supportive of the SEC's intent to address the first issue in footnotes 47 and 73 of the proposed guidance. Footnote 47 seems to support the notion of using home country GAAP or International Financial Reporting Standards ("IFRS") for purposes of establishing the scope of management's assessment process. But it is not clear within that footnote whether the reconciliation to U.S. GAAP itself is to be included in management's scope. We believe it was the intent of footnote 47 to include within management's scope the controls over the preparation of the U.S. GAAP disclosure, similar to any other required disclosure in the financial statements. We believe this can be clarified in footnote 47 by stating the following (suggested changes are underlined or struck-through):

> Management of foreign private issuers that file financial statements prepared in accordance with home country generally accepted accounting principles or International Financial Reporting Standards with a reconciliation to U.S. GAAP should plan and conduct their evaluation process based on their primary financial statements (i.e., home country GAAP or IFRS). ~~rather than the reconciliation to U.S. GAAP.~~ Additionally, controls over the preparation of the U.S. GAAP reconciliation disclosure should be included within management's assessment, the scope of which should be established based on an assessment of materiality to the primary financial statements as prepared under home country GAAP or IFRS.

Additionally, footnote 73 should be clarified. We believe it is appropriate to assess the impact of an identified control deficiency on the home country GAAP or IFRS financial statements, as well as on the U.S. GAAP reconciliation disclosure, considering what would be material in each respective case. We are, however, concerned that the example provided in Footnote 73 does not clearly articulate this concept. We believe it might be more appropriate to highlight that a control deficiency that results or could result in a material misstatement of the U.S. GAAP reconciliation disclosure, even if it does not have a material impact on the home country or IFRS financial statements, is typically a material weakness because the reconciliation disclosure is part of the financial statements filed with the Commission.

The SEC's proposed guidance does not address the issues related to ICFR interim financial statements in the context of FPIs. To clarify such issues, the following should be included in management guidance:

> Consideration of controls over interim financial reporting and the evaluation of deficiencies based upon the consideration of misstatements that could be material to interim financial statements are not applicable to FPIs because they are not required to file reports containing interim financial information with the Commission. FPIs are required to furnish to the Commission any interim financial information that is filed locally. If,

however, the FPI chooses to file, rather than furnish, interim financial statements with the Commission, controls over interim financial reporting should be included within the scope of management's annual assessment of ICFR and deficiencies should be evaluated with respect to the impact on both the interim and annual financial statements.[4]

17. Do the proposed revisions to Rules 1-02(a)(2) and 2-02(f) of Regulation S-X effectively communicate the auditor's responsibility? Would another formulation better convey the auditor's role with respect to management's assessment and/or the auditor's reporting obligation?

We support the Commission's proposed rule amendments that would require the outside auditor to express a single opinion on the effectiveness of the company's ICFR, rather than expressing separate opinions on the effectiveness of the company's ICFR and on management's assessment of the same. As we discussed on our comments on the Concept Release, we believe that these rule amendments will address the existing confusion regarding the auditor's responsibility in an ICFR audit, without affecting any investor protections.

With respect to the auditor's role and the manner in which outside auditors provide the attestation required by Section 404(b) of the Sarbanes-Oxley Act, we believe that an annual audit of internal control over financial reporting is critical to the effectiveness of Section 404. The potential alternative solutions that have been put forward by some commentators would 1) require less frequent audits, 2) limit the scope of the work the auditor performs, or 3) require that the auditor provide an opinion based on less than reasonable assurance. We believe each of these three alternatives have significant shortcomings that would greatly outweigh the benefits.

Alternatives based on less frequent audits of internal control, perhaps every three years or based on a lottery system, would cause confusion in the marketplace as to the level of auditor assurance provided in any given year and may create a two-class system of reporting companies. In addition, when an audit of internal control is only performed occasionally, or even randomly, the benefits of efficiency and auditor knowledge that can be expected to build up from a yearly integrated audit would be lost. Such approaches also are contrary to the concept of consistently maintaining internal control over financial reporting. Similarly, instituting a system whereby the auditor either rotates the testing of major processes among several years or samples a limited number of major processes or controls each year would not result in providing reasonable assurance and therefore would not meet the expectations of investors.

Alternatives based on limiting the scope of the auditor's work, such as reporting only on design and implementation of internal control (i.e., whether the controls have been properly designed and whether they have been placed into operation as intended), would not address the most critical question to investors: Are the controls operating effectively as intended?

Alternatives based on the auditor obtaining less than reasonable assurance on which to base the opinion, would likely not result in detecting most material weaknesses. The moderate level of assurance obtained by the auditor when performing a review of interim financial information is based on the auditor performing inquiries and analytical procedures rather than substantive tests.

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[4] This suggestion has been drafted based on the reference to "interim financial statements" remaining in the definition of material weakness and significant deficiency, but if the reference is removed, then it would no longer be necessary to provide this guidance.

This results in the auditor obtaining only a moderate level of assurance and consequently providing a negative assurance form of report. While the form of report in the context of reviews of interim financial information seems well understood, when attempting to apply the concept of a review to the evaluation of the design and operating effectiveness of internal control over financial reporting, it would be difficult to determine what procedures should be performed other than inquiry because there is no equivalent to analytical procedures in the context of evaluating internal control over financial reporting. For this reason auditing standards have long prohibited reviews of internal control effectiveness. We believe conclusions on the effectiveness of internal control based on less than reasonable assurance (i.e., a high level of assurance) will not be meaningful and will not be understood by investors.

19. ***The proposed revision to Rule 2-02(f) highlights that disclaimers by the auditor would only be appropriate in the rare circumstance of a scope limitation. Does this adequately convey the narrow circumstances under which an auditor may disclaim an opinion under our proposed rule? Would another formulation provide better guidance to auditors?***

    Yes, the proposed revision to Rule 2-02(f) adequately conveys the narrow circumstances under which an auditor may disclaim an opinion.

20. ***We are thus soliciting comments on how the proposed guidance and the proposed new auditing standard will affect the expenditure of effort, and division of labor, between the managers and employees of public companies and their audit firms.***

    In considering the effect of the proposed guidance and the proposed new auditing standard on the total expenditure of effort with respect to Section 404, the two proposals should be evaluated together. This is important because, although management's process and the audit are separate activities, the expenditure of effort on the part of the auditor is impacted by the process management uses to perform its assessment (including the documentation management uses to support assessment). For instance, if management alters the manner in which it completes its assessment such that it is more objective (for example, if management uses internal audit or a third party to perform its assessment rather than a self-assessment process), it will result in an increased ability of the auditor to use management's work to the extent permitted and cause a corresponding decrease in the work the auditor must perform. Additionally, if management prepares and retains documentation supporting its assessment similar to the documentation the auditor is required to have under PCAOB AS No. 3, this would also increase the auditor's ability to use the work of management.

    Therefore, we also believe that due to the efficiency and cost-benefit concerns about Section 404, management should consider how their assessment process, including the available documentation, may impact the audit process. If management and auditors coordinate their efforts such that the auditor can use management's work to the fullest extent permitted under the PCAOB audit standards, efficiencies can be obtained. To encourage this coordination by management and auditors, we recommend that the SEC include a discussion in management's guidance regarding interaction with the independent auditor which includes the above discussion and indicates that coordinated efforts by management and the auditor are crucial for the most efficient process overall.

21. We request comment on the nature of the costs and benefits of the proposed amendments, including the likely responses of public companies and auditors concerning the introduction of new management guidance.

As discussed in our General Comments, we believe the combined efforts underway will benefit companies, especially non-accelerated filers that have not yet implemented Section 404, and help them better manage the costs and efforts expended in the initial years of compliance with Section 404. It may also improve the efficiency of the Section 404 process for companies that currently are subject to those rules. However, we also believe that the benefits achieved by companies will vary significantly based on the facts and circumstances for each particular company, the state of their ICFR within each company, and the extent to which management already has effective ICFR in place. Additionally, the SEC should consider the possibility of potential unintended consequences on the quality of management's ICFR assessments that may result from over-emphasis on efficiency in management guidance when such guidance is applied by a broad population of individual issuers. To avoid such unintended consequences, the SEC should consider discussing the benefits of a quality ICFR assessment process in the management guidance.