Rayonier

Corporate Headquarters

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Mr. Jonathan G. Katz, Secretary
U.S. Securities and Exchange Commission
450 Fifth Street NW
Washington, D.C. 20549-0609

Re: File No. 4-497

Dear Mr. Katz:

We appreciate the opportunity to comment on §404 of the Sarbanes-Oxley Act of 2002 (the "Act"). We are encouraged by the Commission's announcement of next month's roundtable discussion and its solicitation of feedback on the internal control implementation process. While we broadly support the measures that the SEC has taken to improve the quality and reliability of financial information, we believe the effort involved in complying with §404 has greatly exceeded what Congress envisioned, particularly for small and mid-size companies.

By any measure, the costs incurred in complying with §404 have been excessive, even for companies like Rayonier that have a long-standing commitment to a strong system of internal controls. We estimate our §404 implementation costs to date at over $740,000 in out-of-pocket costs and approaching 20,000 hours of management time. We are not at all convinced that the time, effort and costs of §404 implementation, including the unavoidable diversion of management focus from operational and strategic issues, justify the expected benefits.

We are hopeful that the open dialogue the Commission is encouraging will result in a refocusing of compliance efforts on the types of corporate fraud that led to the passage of the Act in the first place, and away from documentation and testing of transaction-level controls which have little chance of preventing or detecting the types of collusion and corporate fraud at the heart of recent corporate scandals.

Specific Suggestions for Improvement

Based on our experience as a mid-cap company in the first year of complying with §404, we have several suggestions to streamline compliance requirements that we believe will meet the objectives of ensuring adequate internal controls over financial reporting while reducing the onerous compliance burden.

Risk-Based Approach

The corporate financial reporting failures of the last few years were ethical failures on the part of senior management, where earnings management and other pressures led to overrides of closing controls, improper revenue recognition, deferral of costs on a massive scale, or misrepresentations of the substance of major transactions. The problems were not with controls over routine transactions and processes in areas such as production costs, inventory, disbursements, receipts, payroll, IT and routine revenue recognition. However, the compliance processes required by the detailed implementing requirements of PCAOB Auditing Standard No. 2 have driven much of the compliance effort toward documenting and testing controls around lower risk, routine areas.

Like most companies, Rayonier identified hundreds of "key controls" under §404 for our material business units and accounts. Although our risk assessments indicated a very low probability that controls in our routine areas were not effective, we were nonetheless required to prepare extensive documentation, test the effectiveness of the controls, and pay for our independent auditor to re-test those controls.

The effort and cost of compliance could be substantially reduced with little risk by permitting more of a risk-based approach, allowing companies to use the results of the exhaustive testing performed initially as a baseline to focus management's assessment and audit testing going forward. Under such an approach, companies and their independent auditors would identify the critical controls over areas involving control environment, substantial management judgment, complex transactions, financial closing and consolidation, and other key areas that could have a material impact on the financial statements and focus their assessments on those areas. Testing of controls identified as lower risk could then be evaluated through inquiry as to changes, limited walkthroughs and periodic detailed testing on a rotational basis, all utilizing the extensive testing performed in the first year as a baseline.

It should also be noted that the large accounting firms have developed guidelines for sample sizes and scope of testing for controls performed daily, weekly, quarterly and annually, and that these guidelines seem to have become a minimum benchmark for testing all controls, regardless of risk or the possible adequacy of audit evidence that can be gained through walkthroughs. We suggest that PCAOB audit standards be clarified to provide for more auditor latitude such that detailed testing of some minimum number of sample transactions may not be necessary for every §404 control, particularly when prior year results were good, when there have been no changes in the control, and the risk of ineffectiveness is low.

Increase Materiality

PCAOB Audit Standard No. 2 defines "significant deficiencies" as control deficiencies involving more than a *remote* likelihood of *a more than inconsequential* misstatement. Significant deficiencies that remain uncorrected after "some reasonable period of time" are presumed to be "material weaknesses".

These definitions require the application of professional judgment in determining materiality. We have noted that some audit firms and their clients have used 20% of overall materiality, or 1% of income before taxes as a materiality threshold for significant deficiencies. In practice, this threshold requires companies, audit firms, and boards to spend a great deal of time formally communicating, reviewing and resolving issues that shareholders would almost certainly not deem worthy of such effort.

As reported in Compliance Week's *An Analysis Of The (Non) Impact of SOX 404,* dated March 8, 2005, most companies that have reported material weaknesses in their internal controls are getting "a pass from investors." This may well be a result of "disclosure overload," driven at least in part by the low materiality and probability thresholds. When so many large, well-established companies are making such disclosures, investors begin to discount the importance of a "clean" internal control report to the long-term success of a company, further reducing the value of an internal control audit opinion and its related disclosures.

Audit Opinion on Internal Controls over Financial Reporting

Section 404 requires only that a company's independent auditor attest to management's assessment of internal controls over financial reporting. However, PCAOB Auditing Standard No. 2 requires the auditor not only to report on management's assessment, but also to express their own opinion directly on the effectiveness of internal control over financial reporting. The PCAOB has indicated that it believes there is no difference in the level of work performed or assurance obtained by the auditor when expressing an opinion on management's assessment or when expressing an opinion directly on the effectiveness of controls. Our experience would very much indicate otherwise. We believe that, as a practical matter, the requirement that the independent auditor express an opinion directly on the controls drives much more extensive audit work and resulting costs than if the auditor were required to only attest to management's assessment.

We believe that a modification to the auditing standard to provide, consistent with the language of §404, that the independent auditor limit their evaluation to management's process of assessment (supported by selected re-testing of management's testing and other independent corroborative testing) would substantially decrease compliance costs while remaining true to the original intent of §404.

Encourage Informal Consultation with Independent Auditors on Complex Accounting Issues

With the complexity of many accounting and disclosure issues, the quality of financial reporting is strengthened when companies are able to consult with and utilize the expertise of their independent auditors. However, the requirements of PCAOB Auditing Standard No. 2 for the independent auditor to formally assess the effectiveness of a company's controls have had the perhaps unintended effect of greatly increasing the formality in how management consults with the auditor on complex accounting matters. Companies must now be very careful in discussing preliminary or "draft" views on accounting and reporting issues or providing preliminary financial information to their auditor out of concern that the auditor could view any errors in management's initial positions or early drafts of financial statements as an indication that management lacks adequate expertise and effective controls.

We believe this formality in interaction between management and the auditor detracts from the overall process of ensuring good financial reporting. We suggest that guidance be provided to facilitate a better environment for free discussion and consultation between management and auditors regarding preliminary judgments on complex issues.

IT Controls Guidance

IT general controls that directly, or reasonably could, impact systems and application-level controls that support reliable financial reporting should be addressed in §404 testing. However, we have noted a decided tendency for "scope creep" in §404 testing whereby testing is performed on systems and IT processes that only peripherally impact the financial application systems, or that have only a remote possibility of impacting the overall IT general controls environment as it relates to reliability of financial reporting.

While we recognize that the IT general controls environment will vary from company to company and that a specific, prescriptive approach to standards for auditing the adequacy and effectiveness of such controls is not advisable, some broad guidance as to what IT general control areas should be assessed for §404 is needed.

We thank you for the opportunity to share our views on these critically important issues. Hopefully this dialogue will lead to a reasoned, practical approach to internal controls that will balance the effort and costs of compliance with tangible benefits to investors.

Very truly yours,

W. L. Nutter
Chairman, President and Chief Executive Officer

Gerald J. Pollack
Senior Vice President and Chief Financial Officer