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April 11, 2005

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OFFICE OF THE SECRETARY

Mr. Jonathan G. Katz
Secretary
U.S. Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20459

4-497

Dear Mr. Katz:

In response to the Commission's request for information pertaining to the implementation of the auditing and reporting requirements of Section 404 of the Sarbanes-Oxley Act, the undersigned accounting firms wish to share with the Commission a sampling of data on compliance costs and remediation of internal control deficiencies. As you know, each of the firms has provided its own individual submission with detailed discussions of its views and some specific suggestions for enhancing the 404 implementation process.

To further assist the Commission in its consideration of issues related to 404 and to provide all participants in this matter with new empirical information, the firms jointly commissioned Charles Rivers Associates (CRA) to conduct the attached research project with information for 90 clients from among the *Fortune* 1000 companies that they audit.

We believe the data provides important perspective on some of the most relevant issues in the current public debate. The key findings are:

Costs

- The sampled companies had revenue averaging $8.1 billion and spent an average of $7.8 million on Section 404 compliance in 2004.
- Compliance costs represented about 0.10 percent of total company revenue for these companies.
- Section 404 audit fees averaged about $1.9 million and accounted for one-fourth of the total Section 404 costs in 2004.
- Section 404 audit fees represented about 0.02 percent of these companies' total company revenue.
- Total Section 404 compliance costs may drop as much as 46 percent in 2005 for these companies, according to the auditors sampled.

Control Deficiency Remediation

- Of the companies whose data was included in the sample, there were an average of 271 control deficiencies (some of which possibly would have been classified as significant deficiencies or material weaknesses) identified and remediated in 2004.
- An average of an additional 77 deficiencies are expected to be remediated in 2005.
- Of the deficiencies expected to be remediated in 2005, a vast majority (about 96 percent) are categorized as control deficiencies, but not as significant deficiencies or material weaknesses. An *aggregate* of five material weaknesses were unremediated at the year-end assessment date across the 90 companies sampled.

Quantifying the future benefits of improved, more reliable financial reporting is not fully possible. Nonetheless, we believe the large number of remediated deficiencies observed in the CRA data suggests a level of effort leading to improvement in internal control over financial reporting. While almost all of the identified deficiencies in the CRA report likely did not rise to the level of a material weakness, we believe that investors, our capital markets, and public companies are well served by the improvements that resulted from the 404 process.

In its separate submission on this issue, one of the firms submitting this letter noted that an internal analysis of 225 registrants revealed that more than 40 percent of that group of companies remediated or newly implemented more than 25 percent of their key controls in year one of Section 404. Another of the firms observed that as of March 30, 2005, approximately 140 calendar year-end companies had reported material weaknesses. In our view, the identification of these issues and their resolution are important public benefits. A third firm estimated that about 10 percent of the SEC issuers currently filing 404 reports as part of their annual reports will disclose one or more material weaknesses that were unremediated at the end of their fiscal year. This firm also noted that identification and remediation of control deficiencies and significant deficiencies will improve internal control over financial reporting and, in some cases, prevent the development of material weaknesses.

As also noted in separate submissions by the undersigned firms in advance of the April 13 Roundtable, each of the firms has witnessed an almost universal increase in attention and commitment to internal control over financial reporting on the part of public companies since the enactment of Sarbanes-Oxley. Some of the firms also report that, in addition to the positive effect on internal control over financial reporting, the Section 404 process has benefited public companies and their shareholders by identifying efficiencies in business processes. In the firms' experience, the new reporting requirements also have generated a renewed focus on ethics, anti-fraud policies, and accountability.

Moreover, as indicated in the CRA survey, there is strong reason to believe that the costs associated with 404 compliance will generally decline in 2005. For some issuers, the declines likely will be significant. The firms believe that a number of one-time factors contributed to relatively high costs in the first year, including initial documentation and remediation of key controls, the general challenge of responding to any complex new reporting requirements and some uncertainties about thresholds for "how much is enough." We believe all of these factors will diminish as cost drivers in year two.

Auditors, regulators, and issuers alike all should benefit from a "learning curve" that will bias costs downward. The firms also expect that the ability to perform an "integrated audit" generally will be increased in the second year. The timing of rulemaking and guidance as well as the preparatory process for first-year implementation limited the ability to perform fully integrated audits in 2004.

The firms look forward to participating in the April 13 Roundtable. We hope that the additional data provided today will assist the Commission in carrying out its public responsibilities.

Very truly yours,

Deloitte & Touche LLP
Ernst & Young LLP
KPMG LLP
PricewaterhouseCoopers LLP

Attachments

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SARBANES-OXLEY SECTION 404
COSTS AND REMEDIATION OF DEFICIENCIES: ESTIMATES FROM A SAMPLE OF FORTUNE 1000 COMPANIES

PREPARED BY

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April 2005

CRA No. D06155-00

Section 404 of the Sarbanes-Oxley Act of 2002, in conjunction with related SEC rules and Auditing Standard No. 2 (AS No. 2) established by the PCAOB, requires management of a public company and the company's independent auditor to issue two new public reports:

- A management report on the effectiveness of the company's internal control over financial reporting.
- In conjunction with the audit of the company's financial statements, an independent auditor's report that includes both an opinion on management's assessment and an opinion on the effectiveness of the company's internal control over financial reporting.

In response, public issuers initiated last year an intensive examination of their internal control over financial reporting. Section 404 also has prompted significant public debate about the magnitude of this effort and the associated benefits.[1] A number of public officials and investor representatives have lauded the Section 404 requirements as providing significant new protection against corporate fraud and have predicted that the new reporting would improve the reliability of public companies' financial statements. Some business executives and audit committee members have said that the Section 404 requirements have enabled them to improve internal control systems over financial reporting and enhance aspects of operational effectiveness overall. Other business leaders have commented that the cost of compliance with Section 404 exceeds the benefits and have urged regulators to modify implementation rules to reduce the costs associated with Section 404.

To assist in the evaluation of the conflicting claims by injecting additional empirical data into the public discussion of Section 404, the nation's four largest accounting firms asked Charles River Associates (CRA) to review relevant data for a sample of 90 of the firms' clients belonging to the *Fortune* 1000.[2]

For each company, auditors on the specific client account collected the client-specific data on client revenues and Section 404-related audit fees and deficiencies for 2004. They also provided their best estimates of 2004 and 2005 total of Section 404-related issuer costs. The firms then averaged the results for the companies for which they were able to provide data and estimates, and the averages were provided to CRA.

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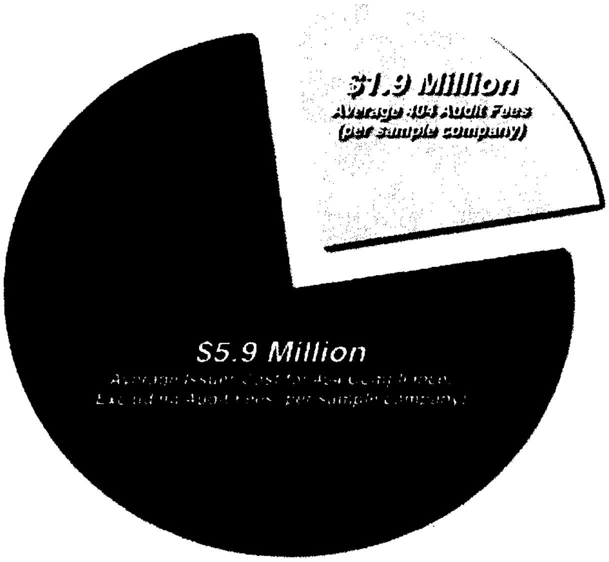
[1]See, for example, "Accounting Rule Exposes Problems But Draws Complaints About Costs," by Deborah Solomon, *The Wall Street Journal,* March 2, 2005; "Businesses are Pushing Against Requirements of Sarbanes-Oxley Act," by David Nicklaus, *St. Louis Post Dispatch,* January 26, 2005; "Compliance Law Changes Urged," by Andrew Countryman, *Chicago Tribune*, January 3, 2005; "Death, Taxes & Sarbanes-Oxley?," *BusinessWeek*, January 17, 2005.

[2] See the Appendix for more on sample selection and data definition.

Average 404 Compliance Costs Per Company-2004



Section 404 Audit Fees Accounted for One Quarter of Total Section 404 Compliance Costs

Consistent with other anecdotal evidence, a review of the data provided by the four firms shows that these issuers spent substantial sums in connection with the new reporting requirements.

On average, the companies in the sample were estimated to have spent a total of $7.8 million each to implement Section 404 overall, including audit fees related to Section 404. These audit fees accounted for approximately one quarter of the total compliance costs, or an average of $1.9 million.

These estimates suggest that, on average, Section 404 compliance costs represented slightly more than one-tenth of one percent of total company revenue in 2004, and fees for audit work related to Section 404 represented about 1/40th of one percent of revenue for the companies sampled.

2004 Costs of Compliance with Section 404, Average per Company in Sample

Average Audit Fees	$1.9 Million
Average Issuer Costs, Excluding Audit Fees	$5.9 Million
Total Average Compliance Costs	$7.8 Million
Average Company Revenue	$8.1 Billion
404 Compliance Costs as a Percent of Revenue	0.10 %
404 Audit Fees as a Percent of Revenue	0.02 %

Data for 90 *Fortune* 1000 companies

Deficiencies Remediated or Identified for Remediation Next Year

A primary benefit of Section 404, according to some observers, is that the heightened attention to internal control over financial reporting created by Section 404 will enhance the reliability of financial statements by helping companies to identify internal control deficiencies and enabling them to remediate these deficiencies in a timely fashion.[3]

For Section 404 purposes, management and the independent auditor are required to disclose in their public reports only material weaknesses that exist as of the year-end assessment date. Whether deficiencies are identified by management or the auditor, management may implement new controls or strengthen existing procedures to correct deficiencies before the company's year-end assessment date, in effect remediating these potential problems. By identifying and remediating control deficiencies during the year, fewer material weaknesses likely were reported.

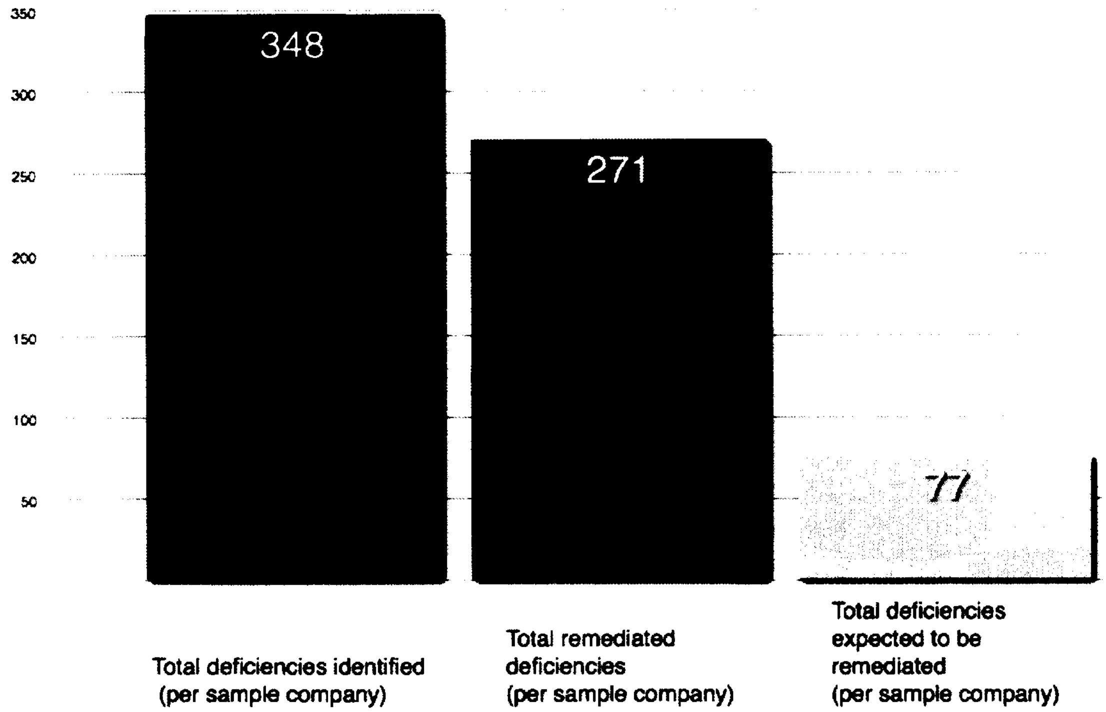
The survey gathered information about the total number of deficiencies identified by the issuer or the auditor in the Section 404 implementation process and remediated prior to the year-end assessment date. If a deficiency was remediated prior to the year-end assessment date, management and auditors would not necessarily have evaluated whether the deficiency would have been a significant deficiency or material weakness as defined by the PCAOB in AS No. 2. Therefore, the number of deficiencies remediated prior to the year-end assessment date was collected in the aggregate without determination as to whether some would have been classified as significant deficiencies or material weaknesses.

The data shows that sampled companies remediated an average of 271 deficiencies prior to their year-end assessment date.

The survey also collected data on the number of deficiencies identified by the issuer or auditor in the Section 404 implementation process that were not remediated by the year-end assessment date but were expected to be remediated thereafter. These deficiencies were broken down by classification.

[3] Donald T. Nicolaisen, Chief Accountant, SEC, Interview with *Journal of Accountancy*, January 2005; Keynote speech by Charles D. Niemeier, AICPA Annual SEC and PCAOB Conference, December 7, 2004; "Telling It Like It Is," by William M. Sinnett, *Financial Executive*, January 1, 2005; "Compliance Law Changes Urged," by Andrew Countryman, *Chicago Tribune*, January 3, 2005.

Average Deficiencies Per Company Year End 2004[4]



The sampled companies identified about 77 additional deficiencies on average for subsequent remediation. Of these unremediated deficiencies, almost 96 percent were classified as control deficiencies not rising to the level of a significant deficiency or material weakness. The standard defines a control deficiency as "a deficiency when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis." The data show an average of 74 control deficiencies and three significant deficiencies per company still existed and were expected to be remediated after the year-end. A *total* of five material weaknesses were unremediated as of the year-end assessment date across the 90 companies for which data was available.

[4] For important additional descriptive information, see the note attached to the table Supplemental Materials on page 8.

Compliance Costs Expected to Decline in 2005

It has been suggested that some Section 404 compliance costs in 2004 are one-time start-up expenditures and "learning curve" costs that typically occur with any new compliance regime. Others have suggested that the first-year costs for some companies also include "deferred maintenance" of internal control systems that have been allowed to degrade.[5]

If these views are correct, compliance costs associated with Section 404 would be expected to decline over time. Survey responses by audit firm members support this hypothesis. On average, the audit firm respondents believe that the total 2005 compliance costs of the clients in the sample, including Section 404 audit fees, will average $4.2 million – 46 percent less than the estimated 2004 costs.

Projected Sample Issuer Costs of Compliance with Section 404 of Sarbanes-Oxley – 2005

Category	Costs	Percent Decline 2004-2005
Projected Issuer Total Costs, Including Audit Fees (Average Per Company)	$4.2 million	- 46%

[5] "Corporate Backlash Over Sarbanes-Oxley: Disclosure Law Called Overly Onerous," by Jenny Strasburg, *The San Francisco Chronicle*, March 23, 2005; Remarks by Daniel L. Goelzer, PCAOB member to 21st Annual Washington Economic Policy Conference, March 21, 2005.

APPENDIX: SAMPLE SELECTION AND DATA DEFINITIONS

The four largest public accounting firms asked Charles River Associates (CRA)[6] to assist them in gathering and compiling information pertaining to costs and deficiencies identified as a result of the implementation of Sarbanes-Oxley Section 404. To attempt to provide a representative sample of *Fortune* 1000 clients of the four firms, the firms were asked to seek information on a total of 96 clients randomly selected from the population of all of the firms' *Fortune* 1000 clients. The firms were able to supply at least some responses for 90 of these clients.

To measure the costs of implementation of Section 404 for the public companies in the sample, the four firms provided data pertaining to the following categories:

- 2004 fees paid by issuers for Section 404 audits.
- 2004 and 2005 total issuer costs for Section 404 compliance (projected by the audit firms). Total costs include Section 404 audit fees as well as the cost of hours expended by issuer personnel, fees paid to providers other than the auditor, and out-of-pocket expenses for travel, recruiting, hiring new personnel, training, software purchase, etc. directly related to Section 404 implementation.

To measure the average number of deficiencies identified as a result of Section 404 implementation for the surveyed firms, the firms provided data for each company pertaining to the following categories:

- 2004, total deficiencies (control deficiencies, significant deficiencies and/or material weaknesses) identified either by the issuer or the auditor as a result of Section 404 implementation and remediated prior to the year-end assessment date.
- 2004, "control deficiencies" identified either by the issuer or the auditor as a result of Section 404 implementation and not remediated prior to year-end but that are expected to be remediated subsequent to the year-end assessment date.
- 2004, "significant deficiencies" identified either by the issuer or the auditor as a result of Section 404 implementation and not remediated prior to year-end but that are expected to be remediated subsequent to the year-end assessment date.

[6] The primary authors of this report are Perry Quick and Jay Johnson, Charles River Associates, Washington, DC. They can be reached at 202/662-3800. The views expressed herein are those of the authors and do not necessarily reflect the views of other CRA staff.

- 2004, "material weaknesses" identified either by the issuer or the auditor as a result of Section 404 implementation and not remediated prior to the year-end assessment date such that they will be reported in connection with the issuer's 10-K.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the company's ability to initiate, authorize, record, process or report external financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the company's annual or interim financial statements that is more than inconsequential will not be prevented or detected. A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected.[7]

For each firm, auditors on the specific client account collected the client-specific data on client revenues and Section 404-related audit fees and deficiencies for 2004. They also provided their best estimates of 2004 and 2005 total Section 404-related issuer costs. The firms then averaged the results for the companies for which they were able to provide data and estimates.

In order to maintain the confidentiality of the clients in the survey, the firms provided CRA with only the sample averages, the number of responses and a measure of variance. From the data obtained we have aggregated the individual firm numbers, and presented the results in the attached tables.

[7] http://www.sec.gov/rules/pcaob/34-49544.htm#toc1.

Supplemental Materials

2004 Deficiencies
Identified Through the Implementation of Section 404

	Number of Deficiencies	Number of Companies in Sample
Average Deficiencies Remediated	271.0	88
Average Control Deficiencies Not Remediated	73.5	88
Average Significant Deficiencies Not Remediated	3.1	90
Average Material Weaknesses Not Remediated	0.1	90

Note:

The term "deficiencies" includes control deficiencies and those that could have been determined to be significant deficiencies or material weaknesses, and therefore reflects a wide variation in matters identified, both in terms of severity of the effects on the financial statements and the effort required for remediation.

The definition of control deficiencies, significant deficiencies and material weaknesses are used as set forth in PCAOB Auditing Standard No. 2, and are summarized below:

- A *control deficiency* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A control deficiency that is not a significant deficiency or material weakness generally relates to deficiencies where there is a remote likelihood of an undetected, material misstatement occurring in the financial statements.

- A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the company's ability to initiate, authorize, record, process, or report external financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the company's annual or interim financial statements that is more than inconsequential will not be prevented or detected.

- A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected.

2004-2005 Internal and External Costs
Incurred by the Issuer as a Result of Section 404 Implementation

	2004	2005	Change
Section 404 Auditor Fees (Millions of Dollars)[1]	$ 1.9		
Percent of Total Costs	*25%*		
Number of Companies in Sample	90		
Total Issuer Section 404 Costs (Excluding Audit Fees)[1] (Millions of Dollars)	$ 5.9		
Percent of Total Costs	*75%*		
Number of Companies in Sample	69		
Total Issuer Section 404 Costs (Millions of Dollars)[1]	$ 7.8	$4.2	*-46%*

Notes:

1. These are averages for companies for which data was provided by the four accounting firms.