Sarbanes-Oxley 404- A Corporate Practitioner's View.

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I have worked as an external auditor of public companies for a Big Four accounting firm, an internal auditor for two public companies, and an accounting manager and director for both a US and a foreign-registered public company. I have been heavily involved in Sarbanes-Oxley section 404 implementation at two companies, both as a process owner and a project leader.

It is with that background that I make the comments below. I do not speak for the Board of Directors of my company, nor the shareholders.

I do not regard section 404 of the Sarbanes-Oxley Act as written, as anti-business, or as a waste of effort and time. The statute as written is not overly specific, and allows latitude to implement and enforce it. Under ideal implementation and enforcement, companies could opine on their controls, and auditors could opine on those companies' opinions, using tailored, logical means to discern the true risks of misleading financial disclosures that can result from poor controls.

However, the tailored and focused approach that is needed has **not** been adopted. Furthermore, in its implementation, the section has not been kept in context with the other sections of Sarbanes-Oxley**. The corporate governance, whistleblower protection and auditor independence requirements of Sarbanes-Oxley have already been implemented, and it is in that environment, not in a vacuum, that 404 should have been, and should be, enforced.** 404 is a good section of a good statute, and deserves rework for the 2005 financial statement cycle.

The biggest single problem that I have been able to identify with the implementation, the problem that has inflated the cost of compliance beyond the expectations of anyone involved in enforcement or compliance, has been the number of "key controls" that companies have had to test. At my company, a small R&D company that, on a market capitalization basis, was not small enough to qualify for the two-year compliance extension, there are many more "key controls" than employees. I am sure that is not atypical for smaller filers.

Furthermore, it is clear that none but a small handful of those "key" controls would have any bearing on preventing real misstatements. For example, the investors and potential investors have not been safeguarded to any real extent by ensuring that invoices are sequentially numbered, or that network passwords are sufficiently complex. I do not intend to make light of those controls, however the relationship between such best-practice controls, and the degree of confidence investors can have in the financial statements and disclosures, is an indirect one at best.

Internal controls are tested in a detailed manner as part of the financial audit done by the external auditors, so the idea of 404, taken along with sections 302 and 906, is to go an extra step beyond the detailed testing done by the auditors, to make management review its most critical procedures, so that the signoffs that are done to comply with 302 and 906 become more meaningful to all.

In other words, with the Sarbanes-Oxley Act in place, not only is management telling the investing public that it stands by the financial statements, but it also has confidence in the company's high-level review procedures.

It is nonsense to think that a very small, non-complex company can have several hundred high-level, or "key," procedures to prevent misstatements. By ignoring this, using a comprehensive approach, looking at all financial assertions in the "major" cycles, and only excluding very few accounts and processes from that review, the review becomes a huge one relative to the size of the financial reporting process that it is reviewing.

In our case, with several hundred controls to test, the initial choice became to either hire an experienced resource, or outsource and pay high hourly rates. In the end we wound up doing both of these things. For an R&D company such as ours, those high costs came out of the same pool of capital that would otherwise be devoted to core R&D; therefore, the incremental cost associated with focusing on non-critical controls had a direct adverse impact on the progress and competitiveness of the company.

In contrast, if the interpretation of 404 had been a more tailored one, we could then have focused on the handful of truly critical controls, in which case management could have marshaled internal, existing resources to test those controls, with perhaps a small amount of outside advisement needed.

As it stands, with our 404 testing coming to a close, the shareholders can hopefully derive a greater sense of confidence in the financial statements, not from our review of sequentiality of invoices, but from our review of the same handful of truly critical controls that should have been the **only** target of our 404 compliance for the year.

We cannot change what happened in 2004/05 reporting cycle; however, we hope the lessons we have all learned can bring us to a more logical and proportional enforcement process for future compliance.

Thank you very much for eliciting public comment. I look forward to attending the webcast.

Keith Kaplan