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Mr. Jonathan G. Katz,
Secretary,
Securities and Exchange Commission,
450 Fifth Street, NW,
Washington DC 20549-0609

Re: File Number 4-497

Feedback on Implementation of Internal Control Reporting Provisions of Section 404 of the Sarbanes Oxley Act

Dear Sirs,

We welcome the opportunity to comment on the impact of Sarbanes Oxley, particularly Section 404. Pearson supports the principles of good corporate governance and transparent financial reporting and disclosure, wherever we list our securities.

In many ways - from strengthening audit committees to changing company behaviour –Sarbanes Oxley has already helped improve US corporate governance standards. However, the implementation of Section 404 has been challenging and complex. We believe it uses a disproportionate level of resources, both financial and human, for the benefit it will provide companies and investors. Our view, as a foreign registrant, is that this puts companies listed in the US at a competitive disadvantage to competitors elsewhere.

At the heart of the problem are the definition and relevance of controls and the amount of detail required to judge their effectiveness. There are three major areas where companies need better guidance: documentation, identification of key controls and testing. To date, the most detailed available guidance is the PCAOB's Auditing Standard #2, written for external auditors. As a result, interpretations of Section 404 requirements are too often made from the perspective of the external auditor rather than the company.

This means that to avoid losing details that might be considered important by the external auditors, companies like ours have been/are documenting every possible aspect of their business transactions, down to the lowest level. In this first year, documentation and testing too often reflect the resources and time available, in the absence of proper guidance as to what counts as critical and what is trivial.

In response to these problems we have three recommendations for the Commission to consider. These are intended to strengthen the effectiveness of Section 404 for companies, regulators and investors alike. To do this needs a better focus on what is truly important. We have no wish to abdicate responsibility for reviewing and reporting on the effectiveness of financial reporting controls.

1. First, we suggest that you form a working party of business practitioners, regulators and auditors to review the implementation issues and to develop clear practical guidelines and best practice for ***companies***. This review should take into account the valuable lessons learnt from US domestic registrants in 2004. It should also look how other countries' corporate

governance approaches, such as the Turnbull Guidance on risk and internal control in the UK, address these issues.

The working party's guidelines and best practice should cover the following:

- *A 404 methodology*. This should be principles-based rather than the more prescriptive "tick the box" approach currently adopted by the external audit profession;

- *Examples* of the appropriate level and detail of documentation required;

- *Identification of key controls,* with clear stratification of risks and controls to ensure that only key controls are considered. Guidance should also be given for monitoring type controls, which are often informal in nature and therefore more difficult to document. For certain common business processes - for example, billing, accounts payable, payroll - a definition of the expected minimum key controls should be developed. This would be particularly helpful for general IT controls: an area where many companies have had real difficulties in agreeing the appropriate control levels;

- *The depth and frequency* required for testing. Smaller sample sizes and rotation of controls testing should be considered;

- A *clearer definition of control deficiencies*.

In addition to these, the review might also look at whether there should be a consistent definition of materiality levels. Currently external audit materiality levels under Section 404 are lower than those required for financial statement audits. It could also review the independence rules for company testers as there appears to be a conflict between company ownership and testing independence. The role of self assessment in management's internal control attestation should also be explored.

2. We would encourage the PCAOB to review Auditing Standard #2, taking account of the experiences of the first year of Section 404. Any such review could be carried out in conjunction with the working party suggested above.

3. Finally, we believe that auditor independence issues need to be considered. The lack of guidance on Section 404 and the new rules on external auditor independence are unhelpful for the relationship between companies and their external auditors. Auditor independence clearly needs to be maintained above all. However, it is impractical and undesirable for external auditors to stop providing advice and communicating their views on key controls to their clients. The rules in this area should be revisited to reflect the need for management and auditors to cooperate effectively to ensure high quality financial reporting for stakeholders.

Over and above all this, we firmly believe that the culture of an organisation and the values established by senior management are the critical, defining elements behind good corporate governance. Although "tone at the top" is addressed under the COSO framework, in practice this is largely being lost in today's prescriptive approach. Here, above all, a principles-based approach to Section 404 - with less emphasis on detailed transaction review - could make a real difference.

It is vitally important to all concerned that stakeholders have confidence in the quality of companies' financial reporting controls. Section 404 is making a positive contribution to this but it needs to be implemented in a more cost effective manner. The current approach will require significant ongoing incremental investment, with limited investor benefits in relation to the costs incurred.

We hope our suggestions will assist in the development of a more pragmatic approach to the implementation of Section 404. If this cannot be done, a US listing is likely to become increasingly unattractive, particularly to foreign companies, which may in future seek to list in alternative capital markets.

Yours sincerely,

Rona Fairhead
Chief Financial Officer