THE FINANCIAL SERVICES ROUNDTABLE

1001 PENNSYLVANIA AVENUE, NW
SUITE 500 SOUTH
WASHINGTON, DC 20004
TEL 202-289-4322
FAX 202-289-1903

E-Mail rich@fsround.org
www.fsround.org

RICHARD M. WHITING
EXECUTIVE DIRECTOR AND
GENERAL COUNSEL

April 1, 2005

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

Re: Implementation of Sarbanes-Oxley Internal Control Provisions, File No. 4-497

Dear Mr. Katz:

The Financial Services Roundtable[1] ("Roundtable") offers the following comments in conjunction with the Commission's Roundtable on implementation issues surrounding Section 404 of the Sarbanes-Oxley Act of 2002.

Background

The Sarbanes-Oxley Act went into effect in July 2002 and introduced major changes to the regulation of corporate governance. One of the most challenging aspects of the Act is Section 404. Section 404 requires annual management assessments of the effective internal control over financial reporting companies. Issuers are required to publish information in their annual reports concerning the scope and adequacy of the internal control structure and procedures for financial reporting. This statement assesses the effectiveness of internal controls and procedures and discloses any "material weaknesses" in these internal controls. The registered accounting firm shall, in the same report, attest to and report on its assessment of the effectiveness of the internal control structure and procedures for financial reporting.

---

1 The Financial Services Roundtable represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Roundtable member companies provide fuel for America's economic engine accounting directly for $18.3 trillion in managed assets, $678 billion in revenue, and 2.1 million jobs.

Roundtable comments

The Roundtable supports the goals of the Sarbanes-Oxley Act. Roundtable member companies believe strong corporate governance and transparency of management structure and internal controls are important. However, Roundtable member companies are struggling with implementation of the requirements of Section 404. Roundtable member companies have substantial concerns about the additional regulatory burdens and costs imposed by the Sarbanes-Oxley Act. Our member companies have noted the following issues:

1. The Changing Role of Auditors
   - Auditors are hesitant to advise clients
   - Auditors are going overboard in the scope of their testing
   - Auditors are requiring excessive documentation
   - There has been a large increase in outside audit fees
   - Auditors do not have adequate resources to conduct internal control audits
   - Companies are receiving conflicting guidance from external auditors

2. Section 404 has Created Significant Initial and Ongoing Costs

3. Lack of Clarity in Interpreting Standards under Section 404
   - Additional guidance is needed from regulators

4. Depository Institutions are Subject to Similar, Duplicative Requirements under the Federal Deposit Insurance Corporation Improvement Act

1. The Changing Role of Auditors

Roundtable member companies are concerned about the role of auditors in the new regulatory environment. Auditing Standard No. 2 released by the Public Company Accounting Oversight Board ("PCAOB") in March 2004 requires auditors to perform extensive testing and requires numerous documents from financial institutions. Auditing Standard No. 2 creates substantial penalties and increased liability for auditors that fail to report financials accurately. Auditors have reacted to this potential liability by performing testing and requiring documentation that is unnecessary. The standards being used by auditors are beyond those required under the statute and the PCAOB's guidance. The result is increased costs for audits and the need for companies to allocate extensive internal resources to prepare for these audits. The benefits of the additional work being done by auditors do not appear to outweigh the costs.

Auditors are hesitant to advise clients

Roundtable member companies are having difficulty because auditors do not want to offer an interpretation or opinion due to the potential liability associated with that interpretation. Auditors are reluctant to offer advice on the application of generally accepted accounting principles ("GAAP"). Most questions posed to external auditors by management are being referred back to the audit firm's national office. This slows down the process and does not assist management in its assessment of internal controls.

The current system does not encourage management to communicate with auditors. Auditors are tasked with examining management after their internal evaluations are completed. If management were to report a potential problem to an auditor or ask for an interpretation, a reportable material weakness would result. For this reason, management often waits until significant internal reviews have been completed before contacting the auditor. This lack of communication is not helpful for the company and delays the audit process. If the goal is to ensure proper internal controls, management could be assisted by drawing upon the expertise of external auditors to achieve this purpose. Furthermore, since auditors cannot advise management in advance about what to do to avoid a material weakness finding, many companies are forced to consult additional external auditors for an opinion.

Auditors are going overboard in the scope of their testing

Because of the requirements of Auditing Standard No. 2, auditors have increased the scope of their testing, especially in the area of internal technology. The Roundtable believes that the scope of testing exceeds what is required under the guidance. The increased testing suggests that auditors are holding institutions to an impossible standard when evaluating management's assessment of internal controls. According to Auditing Standard No. 2, management must provide reasonable assurances about the effectiveness of internal controls. "Reasonable assurance" means the remote likelihood that material misstatements will not be prevented or detected on a timely basis. External auditors appear to be seeking "absolute assurance" that no fraud or errors will occur under a company's internal control structure.

The Roundtable believes auditors' attitudes toward testing and the absolute assurance standard have increased costs and made it more likely that a company will have to report a material weakness, even when one may not exist. In order to alleviate the excessive testing, Roundtable member companies *recommend* that external auditors rely more on an institution's internal audit and review internal controls based on the reasonable assurance standard defined in Auditing Standard No. 2.

Auditors are requiring excessive documentation

Roundtable member companies are concerned about documentation requirements under Section 404, including what documents must be produced and maintained. Roundtable member companies believe that external auditors are shifting the risk to companies by requesting more documentation. The documentation requests made by external auditors require significant internal resources to compile the data requested. In response to this changing environment, companies have been forced to re-evaluate document retention policies. Proposed changes to these policies would require companies to purchase additional software and train employees. The Roundtable *recommends* that regulators provide additional guidance to auditors in order to reduce the amount of documentation required to be produced or retained.

Increase in outside audit fees

The Roundtable recognizes that due to the new requirements of Section 404 audit fees will increase. However, we believe that some fees are excessive and unnecessary. A recent survey completed by Financial Executives International ("FEI") found that fees paid to external auditors have increased fifty seven percent over the last year. There are several factors for this significant change. First, auditors have increased the scope of their testing and have gone into finer detail on audits. This is partly due to the potential liability and sanctions for auditors under PCAOB guidance. It is also the result of audit partner compensation incentives. Second, auditors have had to develop new software and systems to perform internal control audits. Third, auditors are in a unique position since there are so few qualified individuals to perform these audits. This allows auditors to charge exorbitant fees. Fourth, because the auditors have limited resources, they have less experienced auditors performing audits. These inexperienced auditors require additional time to perform the same function as it would take an experienced auditor. The audit firm charges the client for these extra hours.

Roundtable member companies *recommend* that regulators provide further guidance that would eliminate some of the confusion and risks associated with audits. The goal should be for external auditors to conduct streamlined, cost-efficient examinations.

Auditors do not have adequate resources to conduct internal control audits

Roundtable member companies have reported that auditors at the "Big Four" accounting firms appear to have too few resources to handle the task at hand. There are limited auditors with the expertise to perform audits for both the financial statements and the internal controls. In particular, the lack of experience is evident in the internal control audits. This inexperience leads to differing opinions and delays in the audit process as questions often are referred back to the audit firm's national office. Some of these issues could be remedied if communication between internal staff and external auditors was

encouraged. It would also be helpful if external auditors relied more on the work of internal staff.

Roundtable member companies are concerned about the lack of resources and believe that regulators should ensure that tough penalties for audits do not discourage experienced auditors from continuing their practice.

Conflicting guidance from auditors

Roundtable member companies are concerned about the inconsistent, if not arbitrary, application of the PCAOB audit standard by accounting firms or even engagement teams within firms. In particular, there appear to be variances among firms about what constitutes a material weakness or significant deficiency. Our member companies' views on internal controls sometimes differ from what the external auditors demand. The lack of clarity leads to uncertainty and disputes. There are also significant inconsistencies on external auditors' reliance on internal audits and reviews.

These inconsistencies lead to unnecessary risks for companies based on their choice of external auditor. This may result in the unintended consequence of creating competitive disparities in the marketplace.

2. Section 404 has Created Significant Initial and Ongoing Costs

Roundtable member companies are concerned about the costs associated with the initial implementation and ongoing costs associated with Section 404. The costs are staggering. A recent Financial Executives International survey indicates the total cost of compliance is estimated at $4.36 million per company.[2] AMR Research estimates that companies will spend $5.8 billion on meeting Sarbanes-Oxley Act requirements in 2005.[3] The AMR Research study concludes that despite initial thoughts that Sarbanes-Oxley spending would be a one time expenditure, thirty six percent of companies plan to increase spending, fifty two percent will maintain current levels and only twelve percent will decrease Sarbanes-Oxley related spending.

These costs include large increases in external costs for consulting, software and other vendors, additional personnel (including management time), more paperwork, and an increase in the fees charged by external auditors. Section 404 requirements have changed

---

[2] See Financial Executives International's web site for details, www.fei.org.

[3] AMR Research press release, "AMR Research Estimates Sarbanes-Oxley Spending Will Reach $5.8 Billion in 2005" by Kevin Reilly (Friday, November 12, 2004).

the structure of companies. Some financial institutions have created a whole new 404 compliance staff to deal with these issues. In some cases, the new requirements have diverted management's attention and resources from other risk management issues which could have a negative impact on business operations.

In addition to redefining internal company structure, the Roundtable believes the costs could have an adverse impact on the marketplace in general, including forcing companies to go private to avoid compliance burdens, passing on costs to consumers, or affecting companies' business decisions to enter new markets. The costs are likely to be felt more by smaller institutions. Roundtable member companies believe that Congress and regulators should review at some later point in time whether the benefits of 404 outweigh the costs.

3. Lack of Clarity in Interpreting Standards under Section 404

Roundtable member companies are allocating significant resources to interpret Section 404 standards. There is confusion over the interpretation of terms such as "material weakness" or "significant controls". The business community requires greater clarity on these issues. While the Roundtable appreciates the Questions and Answers and interpretive guidance developed by the PCAOB to date, we believe there are areas in which additional interpretations are needed.

Additional regulatory guidance is needed

The Roundtable *recommends* additional regulatory guidance for specific terms under Section 404. The Roundtable also *recommends* that institutions be given more flexibility for remediating internal control problems and increased time to correct internal control weaknesses.

It is difficult to generalize, but in many cases where companies report material weaknesses, those weaknesses involved one-time problems with specific controls rather than systemic weakness. In most cases these weaknesses are remediable. Roundtable member companies believe there should be more flexibility to correct these weaknesses prior to reporting. There is significant reputational risk associated with Section 404 compliance and the consequences of reporting a "material weakness". We believe there should be some relief for one-off problems than are not indicative of a systemic weakness. The Roundtable also believes that companies should be given more time to correct internal control weaknesses prior to reporting the issue. This is especially true for issues that are brought to the auditors' attention early in the audit process.

4. Depository Institutions are Subject to Similar, Duplicative Requirements under Federal Deposit Insurance Corporation Improvement Act

The requirements under Section 404 of the Sarbanes-Oxley Act are redundant for some Roundtable member companies. The requirements of Section 404 are similar to provisions that are applicable to depository institutions under the Federal Deposit Insurance Corporation Improvement Act ("FDICIA"). Depository institutions with assets over $500 million are already subject to internal control and attestation requirements under Section 36 of FDICIA.

On March 18, 2005, America's Community Bankers submitted a letter to the Federal Deposit Insurance Corporation ("FDIC") requesting that the FDIC amend its rules at Part 363 and raise the threshold of those institutions required to comply with Part 363 from $500 million to $1 billion to give relief to smaller institutions that must comply with FDICIA and Sarbanes-Oxley Section 404.

The Roundtable supports this request and *recommends* that regulators provide additional relief to all depository institutions, regardless of size, that are struggling with redundant compliance burdens. Depository institutions are heavily regulated and supervised by a primary regulator which oversees their compliance with FDICIA. There is no benefit to having overlapping requirements under FDICIA and Section 404.

Conclusion

The Roundtable appreciates the opportunity to comment on issues associated with implementation of Section 404 of the Sarbanes-Oxley Act. The Roundtable would welcome the opportunity to discus our comments with the SEC staff. In the meantime, if you have any further questions or comments, please do not hesitate to contact me or John Beccia at (202) 289-4322.

Sincerely,

Richard M. Whiting

Richard M. Whiting
Executive Director and General Counsel

cc: Mr. William J. McDonough, Chairman, PCAOB