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Ms. Nancy M. Morris
Secretary
Securities and Exchange Commission
100 F Street, NE
Wasington DC 20549-1090

Subject: File Number S7-06-03

Dear Ms. Morris,

Thank you for the opportunity to provide comments on the proposed extension of compliance dates for non-accelerated filers to provide an auditor's attestation on the effectiveness of internal control over financial reporting. I believe that a more rigorous cost-benefit analysis should already have been conducted when the SEC passed its original rule that implemented section 404 of the Sarbanes-Oxley Act of 20002 in June 2003 (see Release No. 33-8238). The SEC should use the opportunity to cure this deficiency by conducting a rigorous cost-benefit analysis and then decide whether to permanently exempt certain categories of issuers.

1) Is it appropriate to provide a further extension of the auditor attestation requirement for non-accelerated filers as proposed? If so, should we postpone this requirement for an additional year as proposed, or would a longer or shorter timeframe be more appropriate?

I believe it is appropriate to delay the compliance dates for the provision of an auditor's attestation report on the effectiveness of the issuer's internal control over financial reporting until the SEC's Office of Economic Analysis has conducted a rigorous empiric analysis of the costs and benefits of section 404(a) and section 404(b) for various categories of issuers, such as non-accelerated filers, accelerated filers, large accelerated filers as well as domestic issuers and foreign private issuers and the Commission has decided on permanent exemptions, or further postponements for categories of issuers. A study of the effects on non-accelerated filers should be given the highest priority. I recommend that the SEC's Office of Economic Analysis also conducts a study whether section 404 was also a contributing factor for the massive delistings and deregistrations by foreign private issuers since the enactment of the Sarbanes-Oxley Act and the effective date of the SEC's eased deregistration rules for foreign private issuers in June 2007.

The length of the extension depends on the scope, methodology and data that the SEC's Office of Economic Analysis wants to use and the research questions that the study is intended to answer.

The length of the extension also depends on the minimum number of months before the end of the fiscal year that the auditors of an issuer need to start with (the interim part) of the audit of the issuer's effectiveness of internal control over financial reporting.

If the SEC's Office of Economic Analysis wants to determine whether the PCAOB's Auditing Standard No. 5 has led to decreases in audit fees, this may be inferred from an analysis of data from forms 10-K, 10-KSB, definitive proxy statements and forms 20-F or from a database of a provider that collects this data from those forms (e.g. AuditAnalytics.com) as soon as the reporting season of the majority of non-accelerated domestic and foreign filers has passed (i.e. in spring). If the SEC wants an analysis of the results of inspections of audits of issuers where PCAOB Auditing Standard No. 5 was applied, this will have to wait until late 2009 due to the time lag between the completion of the audits and the completion of inspections of those audits.

2) How would the proposed extension affect investors in non-accelerated filers?

Investors would not receive the auditor's attestation report on the effectiveness of the issuer's internal control over financial reporting.

However, they already receive management's assessment of the effectiveness of the issuer's internal control over financial reporting. In addition, investors receive information on material changes in internal control over financial reporting. Furthermore, they also receive the auditor's opinion whether the financial statements present fairly in all material aspects the consolidated financial position, the consolidated result of its operations and the cash-flows of the issuer.
On the other hand, the issuer's would not incur the significant increase in audit fees that typically results from requiring an auditor's attestation report on the effectiveness of the issuer's internal control over financial reporting. Any increase in audit fees decreases the net profit available to the investors in the equity securities of the issuer. In addition, investors in debt securities of the issuer are indirectly also negatively impacted by increases in audit fees because they decrease the amount of cash available for interest payments and debt reimbursement and thus results in an increased risk and a potential downgrading of the rating, which has a negative impact on the market price of debt securities.

3) Would the proposed additional deferral of the auditor's attestation report requirement make the application of the Section 404 requirements more or less efficient and effective for non-accelerated filers?

I think the important overall research question is whether the costs of section 404(a) and section 404(b) of the Sarbanes-Oxley Act exceed the benefits for categories of filers, such as non-accelerated, accelerated, large-accelerated, domestic and foreign.

When looking at that question, the long-term average recurring annual costs have to be analyzed. There has been at least anecdotal evidence, that costs in the first year of compliance with section 404(a) and section 404(b) may be higher due to deferred maintenance in internal control over financial reporting and a lack of documentation of internal control over financial reporting. Furthermore, comparisons of the audit fees paid in different years by the same issuer may provide insights whether any actions by the SEC and PCAOB resulted in lower audit fees or whether general efficiency gains that come with practice and relying on the work and assurance of prior year's audits have led to lower audit fees. A comparison of audit fees for fiscal 2004 and fiscal 2005 may show if the SEC's Staff Statement on Management's Report on Internal Control over Financial Reporting and the PCAOB's Staff Questions and Answers on Auditing Internal Control over Financial Reporting that were issued on May 16, 2005 led to any decrease in audit fees of domestic accelerated filers or other issuers that voluntarily already complied with section 404(b) in fiscal 2004.

A similar comparison of issuer by issuer audit fee changes for large accelerated filers between fiscal 2006 and fiscal 2007 can provide an indication of the effect of the SEC's recent Interpretive Rule and the PCAOB's Auditing Standard No. 5.

4) Should management's report on ICFR be "filed" rather than "furnished" during the second year of the non-accelerated filer's compliance with the ICFR requirements under Section 404(a) if we adopt the proposed extension?

The SEC has so far only required that Management's report on ICFR is merely "furnished" rather than filed by non-accelerated filers. I do not see why this approach and the SEC's reasoning for choosing this approach should have changed in the meantime.

5) We request data to quantify the potential costs and benefits described above. We seek estimates of these costs and benefits, as well as any costs and benefits that we have not identified that may result from the adoption of these proposed amendments. We also request qualitative feedback on the nature of the potential benefits and costs described above and any benefits and costs we may have overlooked.

If the SEC's statement in a rule from 22 September 2005 that there are approximately 6000 non-accelerated filers is still valid, an additional cost of only USD 16'666.67 per non-accelerated filer would already make a rule not to extend compliance for non-accelerated filers or not to exempt them on a permanent basis to be a "major rule" for purposes of the Small Business Regulatory Enforcement Fairness Act of 1996.

If the additional cost of having to comply with section 404(a) and section 404(b) of the Sarbanes-Oxley Act results in a material decrease of net profit, this will result in a significant adverse effect on investment. Imposing regulatory costs, which are ultimately diminish the returns of the investors, which are supposed to be protected by this regulation may not promote efficiency and capital formation as intended by Section 2(b) 28 of 1933 of the Securities Act and Section 3(f) 29 of the Securities Exchange Act of 1934.

A number of studies and surveys of the costs of section 404 have been conducted by various parties. They may provide a starting point for the SEC's Office of Economic Analysis to prepare its own study.

Examples of such studies are:

Eldridge/Kealy SOX Costs: Audit Attestation under Section 404 (available on SSRN)
Financial Executives International's annual surveys of SOX 404 Implementation

Foley & Lardner's annual study of The cost of being public in the era of Sarbanes-Oxley

I think the research questions and the research methodology are the two key points that will drive the time needed to conduct the cost-benefit study and its quality.

Examples of research questions are:

Is the ratio of long-term recurring annual costs to annual benefits different for different sizes or nationalities of issuers (by revenue, by assets, by market capitalization, domestic issuer or foreign private issuer)?

Do the average changes in audit fees between fiscal year 2006 and 2007 for individual large accelerated filers or large-accelerated filers indicate that PCAOB Auditing Standard No. 5 led to a significant decrease in audit fees?

Would institutional and private investors think that their perceived benefits exceed the costs of section 404 when they are provided with information about the percentage decrease in net profit due to the costs of section 404(a) and section 404(b) for various categories of issuers (by size, etc.) by the SEC when the question is asked so that they can make a truly informed decision? I think benefits are hard to quantify and that they rely on proving that section 404 decreases material misstatements due to fraud or error. A subjective comparison whether a certain sacrifice in net profit (e.g. 5% or 10%) would be worth a perceived but unquantified benefit is easier to obtain.

Is there a causal relationship between audits of ICFR and a reduction in restatements due to error or fraud that had a material effect on the value of a security from an investor's point of view? Have a sufficient number of years passed to answers this question? Does this depend on the size of the issuer? Are other audit procedures than tests of controls, such as tests of details of balances or transactions and analytical procedures equally effective in detecting material misstatements by smaller issuers? Are those other audit procedures more efficient (i.e. require less audit hours)?

Were the costs and benefits of section 404 one of the reasons for the large number of delistings and deregistrations by issuers from member countries of the European Union and the European Economic Area as well as from Switzerland between 2002 and 2007 (compare number of issuers from those countries at the end of 2001 to the end of 2007)?

Comments on methodology:

While a survey of issuers may be a good method for collecting data about the cost of management’s assessment of the effectiveness of ICFR (i.e. section 404(a)), it may not be the best method to obtain data about the potential cost of the auditor’s attestation on the effectiveness of ICFR. Most non-accelerated filers have probably not obtained quotes of audit fees for an audit that includes a section 404(b) attestation and the audit firms may not have estimated them for all non-accelerated filers. I think that an indirect approach that analyzes the characteristics of non-accelerated filers (their mix in terms of sales, assets, net profit, SIC industry classification and jurisdiction of incorporation and avenue of the use of the public capital market listed/OTC/publicly offered securities) and then looks at audit fee increases of accelerated filers with similar characteristics in the years of section 404(b) compliance versus the prior year, may be better or a good complement.

Other factors than simply a fiscal year in which a section 404(b) attestation was obtained voluntarily or due to SEC rules, can also lead to an increase in audit fees, e.g. a significant percentage increase in sales, material weaknesses in the current or prior year, a change from one accounting standard to IFRS or US GAAP, etc. The SEC’s Office should obtain those factors from database providers and conduct its analysis to control for those factors (e.g. the difference between the percentage increase in audit fees less the percentage increase in sales, etc.).

A survey of issuers should contain questions that provide an indication of the quality and comparability of the answers. E.g.

a) For which of the following costs categories, do you record the costs for management's evaluation of ICFR in your cost accounting or management information system:
- annual costs for external consultants and service providers for designing, documenting or evaluating the effectiveness of ICFR?
- annual costs for new software or modifications to existing software to design, document the ICFR itself or evaluate the effectiveness of ICFR (including documenting the evaluation)?
- internal annual man-hours designing, documenting or evaluating the effectiveness of ICFR?

b) Does your independent's accountant's invoice split the billable hours or fees into the audit of the financial statements and the attestation to the effectiveness of ICFR?

c) Does your independent accountant's quote, budget or forecast the billable hours or fees into the audit of the financial statements and the attestation to the effectiveness of ICFR?

d) Specify the source and thus degree of accuracy of each cost or hours answer:
Is based on see above or best estimate

I hope I was able to provide some valuable suggestions that may help the SEC's Office of Economic Analysis to conduct its section 404 cost-benefit analysis so that the SEC can decide on permanently exempting certain categories of issuers or further extensions of compliance dates for certain categories of issuers. Please do not hesitate to contact me if you have any questions.

Best regards

Georg Merkl