

MEMORANDUM

TO: S7-32-04

FROM: Jennifer G. Williams, Attorney-Adviser
Office of Rulemaking
Division of Corporation Finance
U.S. Securities and Exchange Commission

DATE: August 30, 2004

RE: Release Nos. 33-8477; 34-50254

On July, 28, 2004, Donald T. Nicolaisen, Chief Accountant of the Securities and Exchange Commission, received a letter from James H. Quigley, Chief Executive Officer of Deloitte & Touche LLP, requesting the Commission delay implementation of the second phase of the rule to accelerate deadlines for periodic report filing dates. On August 3, 2004, Donald T. Nicolaisen received a letter from Deloitte & Touche LLP, Ernst & Young LLP, KPMG LLP, and PricewaterhouseCoopers LLP requesting the Commission to recommend delaying acceleration of the Form 10-K filing deadline by one year. The letters are attached to this memorandum.

August 3, 2004

Mr. Donald T. Nicolaisen
Chief Accountant
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, DC 20549

Dear Mr. Nicolaisen:

Deloitte & Touche LLP, Ernst & Young LLP, KPMG LLP, and PricewaterhouseCoopers LLP believe that it is in the public interest to delay acceleration of the Form 10-K filing deadline by one year. Therefore, we request that the staff of the Securities and Exchange Commission (“Commission” or “SEC”) recommend to the Commission a filing deadline delay for one additional year, making the new sixty-day deadline effective for fiscal years ending after December 15, 2005.

Overview

Beginning this year, registrants that are accelerated filers with fiscal year-ends on or after December 15 will be required to file Form 10-K with the SEC within 60 days of their fiscal year-end. This filing deadline is accelerated from 75 days in the past year, and 90 days in the year prior (Appendix A).

Registrants that are accelerated filers will also be required to file their initial reports on internal control over financial reporting concurrent with the filing of their Form 10-K, pursuant to the SEC’s rules to implement the provisions of Section 404 of the Sarbanes-Oxley Act of 2002 (“Section 404”).

The premise underlying our view that a delay is necessary and appropriate *for one year only* relates to the potential unintended consequences that two regulatory requirements could have on the quality of financial reporting: the timeline for filing the Form 10-K is accelerating while many registrants and auditors are finding that the processes surrounding readiness for reporting under Section 404 have been underestimated. Completion of that process by many registrants likely will be either hurried or postponed, a potential outcome that will not serve investors well.

The SEC rule governing the accelerated filing deadlines was passed in September 2002, just two months after Congress enacted the Sarbanes-Oxley Act (Appendix B). When the SEC passed the accelerated filing rule it recognized that a phased-in approach spanning a few years would allow registrants to adjust to significant new changes and requirements in the reporting system. At the same time, a phased-in approach would allow investors to

begin to experience the benefits of an accelerated flow of information. A key to this approach is balancing the benefits to the investor of receiving more timely financial information with the abilities of companies to produce quality financial data. As discussed in more detail below, adopting Section 404 has placed unanticipated demands on registrants that could negatively impact quality: some relief is therefore both necessary and appropriate.

The Level of Effort Necessary to Comply with Rule Section 404 Has Been Underestimated

A May 2004 survey¹ by Financial Executives International (“FEI”) of 83 of its public company members with average revenues of \$3.3 billion stated that the company employee man-hours necessary to be Section 404-compliant ranged widely, from 80 hours to 65,000 hours, and that on average, public companies expect to spend more than 6,000 hours on their readiness efforts. The incremental work occurring in the January-February timeframe will conflict with a statutory filing deadline that has accelerated by 20% (75 days to 60 days) since the prior year.

Over the past two years, many registrants underestimated what was necessary to put in place the processes to comply with Section 404. This underestimation resulted from uncertainties related to the implementation of this new requirement. The level of effort and cost to comply with Section 404 has greatly exceeded their original estimates.

First Time Assessing Section 404 Reporting Requirements and Practical Time Constraints

The preponderance of registrants will issue reports under Section 404 for the first time this year. The level of effort necessary for management to issue its report on internal controls will be over-and-above the effort necessary to issue financial statements and Management’s Discussion and Analysis (“MD&A”), because of the additional documentation, testing and assessment of results required to support management’s assertions contained in a report on internal controls.

For many registrants, the individuals responsible for closing the books and preparing the financial statements are the same ones who are responsible for driving the Section 404 process. Management’s final assessment required by Section 404 cannot be completed until it has evaluated the process for preparing the financial statements and related notes and tested the operation of those controls (for example, posting unique journal entries post-closing).

To finalize its Section 404 assertion, management must evaluate any significant deficiencies and material weaknesses. This evaluation can be finalized only after all of the management documentation and testing work has been completed and all of the deficiencies have been accumulated, aggregated and assessed. Because this is the first application of such a process, the framework for making these assessments is still

¹ See FEI Press Release dated May 30th, and survey results at <http://www.fei.org/news/404/costsurvey.xls>

evolving, and as a consequence registrants will be making judgments against an untested framework. This entails additional time to carefully evaluate results and formulate overall conclusions.

The impact on the capital markets and the marketplace implications of disclosure of material weaknesses under the Section 404 framework is unknown, and additional due care and prudence by registrants in making such judgments about the quality of internal control is critical. This will involve discussions with senior management, the audit committee, legal counsel and auditors on the potentially controversial and judgmental issues. We expect that the most difficult decisions, where there is legitimate room for judgment, will include discussions among a number of constituents to gather views. This process will be very time consuming, but will be time well spent to get to the right answer.

We expect this confluence of factors will place extreme pressure on the management responsible for the preparation of financial and internal control reporting in the February timeframe; and as a result, a disproportionate number of registrants will file Rule 12(b)-25 extensions that could raise unnecessary concerns about the registrant in the capital markets. These concerns could be avoided by delaying the accelerated filing deadline and thus giving the registrant an additional 15 days to complete both its financial and internal control reporting.

The Disproportionate Impact on Smaller Registrants

An analysis of the Form 10-K filing pattern of companies in the Fortune 100 for the years ended 2002 and 2003 shows that the average number of days from year-end to the date of the earnings release increased from 24 to 29 days and the average number of days from year-end to the date of the auditors' report increased from 38 to 45 days. This data does not take into account the additional time required by Section 404 in finalizing a company's periodic report.

We believe that the large-company preparer community will likely have more resources and capability to adapt to the new requirements, while smaller public corporations that are accelerated filers will face bigger challenges. Each of our firms has recently completed training on Section 404, which provided the opportunity for our partners to discuss the issues in the marketplace. Our partners are hearing from many registrants that management underestimated the level of effort that would be required to comply, and that therefore, the companies are behind in their readiness efforts. The burden on the smaller registrant in this regard is disproportionately high.

Audit Firms - Timing Challenges

An important feature of the PCAOB's Auditing Standard Number 2 is the requirement of the auditor to communicate in writing to management and the audit committee all significant deficiencies and material weaknesses identified during the audit. The written

communication should be made prior to the issuance of the auditor's report on internal control over financial reporting.

The audit firm cannot finalize its assessment of internal controls until management has completed its processes and assessment and the audit firm has completed its independent testing. The audit firm will necessarily need to finalize its assessment and report to management and the audit committee after the process of compiling all of the financial statements and footnotes is completed.

We expect that audit firm personnel, in addition to management personnel responsible for preparation of financial and internal control reporting, will be under extreme time pressure during *this year's* financial reporting cycle, particularly in the month of February, unless the filing deadline remains at 75 days.

The Potential Impact on MD&A and Other Management Disclosures

The SEC has consistently encouraged registrants to make thoughtful, reflective and meaningful disclosures. We applaud and also encourage these initiatives. Unfortunately, the quality and breadth of such disclosures this year may be negatively impacted by the concurrent timing pressures associated with the accelerated filing rule, Section 404 compliance and new SEC and Financial Accounting Standards Board ("FASB") requirements. Even though advancements in technology have improved the processes used to gather, prepare, summarize and produce financial data, the preparation of meaningful MD&A and other disclosures for investors requires a thoughtful, in-depth analysis and review of events by management.

We believe that providing quality disclosures to investors is a critical priority that may be unintentionally sacrificed by accelerated filing deadlines *this year*. The recent public debate surrounding the FASB's *Share-Based Payment* Exposure Draft further illustrates that registrants, in addition to representatives from the SEC and the FASB, are concerned about the unintended consequences of standards overload.

Conclusion

As you well know, investors and the public deserve a financial reporting process that provides them with reliable, relevant, and timely financial information. This year, registrants face a particular challenge in concurrently meeting the demands of the first year implementation of Section 404. In the current year, an accelerated Form 10-K filing deadline could compromise the ability to meet this challenge. To support high quality financial reporting, a one year deferral of the Form 10-K acceleration schedule would be in the public interest.

If you have any questions in relation to this letter, please do not hesitate to contact any of the following individuals:

Robert J. Kueppers - National Managing Partner, Risk, Professional and Regulatory Matters, Deloitte & Touche LLP (203-761-3579);
Randy G. Fletchall - Americas Vice Chair, Professional Practice and Risk Management, Ernst & Young LLP (212-773-4043);
Sam Ranzilla - Partner in Charge, Department of Professional Practice, KPMG LLP (212-909-5837); or
Raymond J. Bromark - Americas Leader of Professional, Technical, Risk and Quality, PricewaterhouseCoopers LLP (973-236-7781).

Sincerely,

/s/ Deloitte & Touche LLP

/s/ Ernst & Young LLP

/s/ KPMG LLP

/s/ PricewaterhouseCoopers LLP

CC:

Alan Beller

Erica Sulkowski

Appendix A – Accelerated Filing Schedule (Accelerated Filers)

For companies that meet the revised definition of accelerated filer, the filing deadlines are summarized in the following table:

For Fiscal Years Ending On or After	Form 10-K Deadline	Form 10-Q Deadline
December 15, 2002	90 days after fiscal year end	45 days after fiscal quarter end
December 15, 2003	75 days after fiscal year end	45 days after fiscal quarter end
December 15, 2004	60 days after fiscal year end	40 days after fiscal quarter end
December 15, 2005	60 days after fiscal year end	35 days after fiscal quarter end

Appendix B – Timeline of Significant Events

April 2002 – SEC releases a proposal on accelerated filing deadlines

July 2002 – Congress passes Sarbanes-Oxley

September 2002 – SEC issues final rule on accelerated filing deadlines

June 2003 – SEC issues final rule ‘Management's Reports on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports’

February 2004 – SEC releases an order deferring the effective date of Section 404 from June to November 2004

March 2004 – PCAOB issues an auditing standard on “An Audit of Internal Control Over Financial Reporting Performed in Conjunction with an Audit of Financial Statements” (PCAOB Auditing Standard No. 2)

June 2004 – SEC approves PCAOB Auditing Standard No. 2 and both SEC and PCAOB issue frequently asked question guides on compliance with Section 404

June 2004 – PCAOB issues an auditing standard on “Audit Documentation” (PCAOB Auditing Standard No. 3) and a related Amendment to Interim Auditing Standards

July 28, 2004

Mr. Donald Nicolaisen
Chief Accountant
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Re: Acceleration of Periodic Report Filing Dates

Dear Mr. Nicolaisen:

Deloitte & Touche LLP requests that the Securities and Exchange Commission's (the "Commission") staff recommend that the Commission delay the implementation of the second phase of its rule regarding Acceleration of Periodic Report Filing Dates for a period of twelve months, making it applicable for fiscal years ending after December 15, 2005.

Introduction

We applaud the Commission's efforts to provide the markets with access to information that is clear, accurate, and timely. However, the rule for acceleration of the filing requirements was conceived before Section 404 of the Sarbanes-Oxley Act of 2002 ("Section 404") was enacted and we believe the implementation of the second phase of the acceleration rule could diminish the quality of disclosures and result in increased and unnecessary costs, while not providing significant corresponding benefit to investors. Significant practical issues could impede compliance with the further acceleration of due dates. Shortening the filing period serves to provide more timely information to investors, but further shortening the deadline *this year* places pressure on public company management, legal counsel, financial reporting staff, and audit committees, in addition to the time constraints placed on the independent auditor. We believe the Commission's current focus on providing quality disclosures demanded by the market and investors is paramount and should not be sacrificed for accelerated timing this year.

Time and Practical Constraints and Quality of Disclosures

We believe that the quality and breadth of disclosures may be reduced by the significant practical issues of complying with this rule as well as the requirements of Section 404 and the Management's Discussion and Analysis ("MD&A") Interpretive release will result if the due dates are accelerated this year. The technology available to most companies today allows for rapid accumulation and communication of vast amounts of financial data. However, technology has not meaningfully reduced the time it takes to perform the thoughtful, reflective, and judicious analyses that are necessary to prepare meaningful disclosures about the data. In fact, we believe the time needed to prepare the disclosures required in periodic reports has increased. Also, many companies have underestimated the amount of time and effort that is necessary for management to

complete its documentation, analysis, testing and concluding on internal controls. The individuals who are actively involved in implementing

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the Section 404 processes are, in many cases, the same individuals who are critical to the preparation of disclosures in the companies' periodic reports.

In 2002 we conducted a surveyⁱ of 36 of our clients which requested that they provide a timeline of their periodic reporting preparation. The responses to that survey indicated that large (Fortune 500) companies, prior to the initial phase of accelerated reporting, were taking approximately 25 days to gather the necessary data, 50 days for preparation and review of the annual periodic filing by management, outside advisors and board of directors, and then an additional 6 days to complete the filing process (printing, edgarization, filing). It is our experience that a smaller registrant usually needs more time to complete this process. While our clients were able to shave a number of days off of this timeline so as to meet the 75 day filing due date last year, we believe that much of the time savings may have come from the review processes.

We also have analyzed the Form 10-K filing pattern of companies in the Fortune 100 for the years ended 2002 and 2003. This analysis showed that the average number of days from year-end to the date of the earnings release increased from 24 to 29 days and the average number of days from year-end to the date of the auditors' report increased from 38 to 45 days. This data does not take into account that fact that, pursuant to PCAOB Standard No. 2, *An Audit of Internal Control over Financial Reporting Performed in Conjunction with an Audit of Financial Statements*, auditors may not finalize their report on the financial statements and management's assessment of internal controls until the company has completed all control procedures related to the financial statements which includes reviews by management, outside legal counsel and the board of directors. As such, this will delay the issuance of the auditors' report until just prior to the filing of the company's periodic report.

As reflected above, the adoption of Section 404, thoughtful preparation of meaningful MD&A and other disclosures will take more rather than less time this year, particularly management's initial assessment of internal controls. Further, while certain disclosures may be benefited by new information technology, such as market risk disclosure and option valuations that are computed using complex computer models, most disclosure results from an in-depth analysis and review of events by management. Investors benefit most from reports that include high quality analysis, beyond the inclusion of a high quantity of data.

Consistent with the Commission's message to "Get it Right the First Time," companies, audit committees and their outside advisors and independent accountants are spending more time ensuring that the internal controls are appropriately documented and

functioning and that the company's accounting is correct and its disclosures complete. Since this year is the initial application of Section 404, there is no existing methodology or process for companies and their advisors and auditors to follow in resolving highly judgmental issues concerning significant deficiencies and material weaknesses.

Notwithstanding the registrants' and audit profession's desire for quality financial statements, there is also the very real possibility that errors will go undetected in an accelerated effort to complete procedures so that filings are made by the required shorter deadlines.

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Conclusion

For the reasons presented above, we believe the staff should propose that the Commission delay for twelve months the acceleration of the current due dates for Forms 10-K. Quality must be balanced with timeliness and not unnecessarily sacrificed to provide faster information. In addition, we believe that the multitude of practical and timing concerns may hinder companies' compliance with the further accelerated due dates.

If you have any questions, please contact me at (212) 492-4800 or Robert Kueppers at (203) 761-3579.

Very truly yours,



James H. Quigley
Chief Executive Officer
Deloitte & Touche USA LLP

cc: Chairman William H. Donaldson
Commissioner Paul S. Atkins
Commissioner Roel C. Campos
Commissioner Cynthia A Glassman
Commissioner Harvey J. Goldschmid

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- [i](#) Example based on discussions with numerous large SEC registrants, an analysis of the largest 25 companies on the Fortune 500, and our survey discussed in footnote ii below.
 - [ii](#) We surveyed thirty-six registrants (thirty of which have a market capitalization over \$75 million).