

January 8, 2007

Rule Comments  
Securities and Exchange Commission  
100 F Street, NE  
Washington, D.C. 20549-1090

Re: File Number S7-24-06  
Proposed Amendments to Rule 13a-15(c) and Rule 15d-15(c) under the Securities Exchange Act of 1934 (the “Exchange Act”) and Rules 1-02(a)(2) and 2-02(f) and Regulation S-X  
December 20, 2006

Dear Commissioners,

I am submitting my comments to you regarding the above referenced File Number. These are my personal comments and do not necessarily reflect those of my employer. You asked for general comments—including cost/benefit analysis—as well as approximately twenty-one (21) questions or issues to be addressed.

**Proposed Interpretive Guidance** (Pages 19 – 49)

**1. Will the proposed interpretive guidance be helpful to management in completing its annual evaluation process? Does the proposed guidance allow for management to conduct an efficient and effective evaluation? If not, why not?**

I commend the Commission on this proposal, which I believe will be very helpful to those of us in management. Overall, it encourages efficient and effective ICFR evaluations. There are some areas below where I respectfully recommend adjustments.

**2. Are there particular areas within the proposed interpretive guidance where further clarification is needed? Is yes, what clarification is necessary?**

On page 21 in the first paragraph under the sub-heading, the Commission writes, “...management can avoid identifying and documenting controls that are not important to achieving the objectives of ICFR.” One may discern that this relates to operational controls, such as how to safely work with a warehouse lift. My first reading of this statement led me to believe that the Commission is suggesting that management need not identify and document low risk controls. It appears so, given the example provided on page 25. Perhaps moving this paragraph up will be helpful to readers.

The Commission writes on page 22 that management will have to perform updating of prior year’s(s’) assessment without recreating the work. I personally love that! I am concerned that investors will not be protected in subsequent years. If management tests sixty (60) items for a given control, and it passes without exception, update testing may be sufficient provided there are no changes to the process owner, control performer, and/or the control itself.

Nonetheless, even with no changes, one wonders if another sample of equal size will pass without any sign of deficiency. I ask that the Commission describe what is meant by “update testing,” and whether external auditors (via PCAOB) may also follow this guidance.

Let us go back to page 25 and the top of page 26. The Commission indicates that management may have redundant controls and opt to test the control for which obtaining evidence is more efficient. Is it assumed that these redundant controls are each high risk, and that they each cover the same financial statement assertion(s)? I would question the need for redundancy—unless redundancy is a control itself. If redundancy is a control, *it ought to be tested* for design and operating efficiency! Otherwise, it is my advice to eliminate the lesser efficient control from the ICFR framework. I agree with the Commission’s assertion that automated IT controls are far more efficient, and they ought to be encouraged.

In the middle of page 28 we find a discussion of how management considers general IT control “related to program development, program changes, computer operations, and access to programs and data...” Many companies—especially smaller companies—use spreadsheets to analyze and present financial data. It may be helpful to add reference to spreadsheet testing beyond access to the file. Investors may be stunned to know how many critical numbers may be derived on a spreadsheet, including combining and consolidating financial statements.

Discussion of the implementation procedures to evaluate evidence of the operation of the ICFR on page 36, I find this phrase regarding management’s evidence: “...adjusting the objectivity of those performing the self-assessments.” The PCAOB wants to require an assessment of objectivity of those performing tests. Is it the Commission’s assertion that such objectivity can be changed during the year along a continuum? For instance, a person tasked with gathering evidence on accounts payable controls is in the accounts receivable department. This person may be “objective” in regards to accounts payable. However, if this person partakes in a stock-based benefit plan, the PCAOB proposal would disqualify this person’s work due to a lack of objectivity. The person could temporarily withdraw from the stock-based plan for the period that testing takes place, but this hardly adjusts the person’s objectivity. I heartily recommend that the Commission remove this language and clarify what objectivity is—especially in light of what the PCAOB has in mind.

- 3. Are there aspects of management’s annual evaluation process that have not been addressed by the proposed interpretive guidance that commenters believe should be addressed by the Commission? If so, what are those areas and what type of guidance would be beneficial?**

Unless I have made mention elsewhere in response to specific inquiries, I believe the Commission has captured all aspects of management’s evaluation process.

**4. Do the topics addressed in the existing staff guidance (May [16,] 2005 Staff Guidance and Frequently Asked Questions (revised October 6, 2004)) continue to be relevant or should such guidance be retracted? If yes, which topics should be kept or retracted?**

I find that the *Staff Statement on Management's Report on Internal Control over Financial Reporting* dated May 16, 2005 clearly leads to the guidance upon which we are presently commenting. The Commission may only have to update contact information.

The Commission may wish to revisit replies to the Frequently Asked Questions (revised October 2, 2004) simply because of the passage of time.

**5. Will the proposed guidance require unnecessary changes to evaluation processes that companies have already established? If yes, please describe.**

No, and in fact, I believe that management ought to reassess every year anyway, altering the process as necessary for changes in the organization and business environment.

**6. Considering the PCAOB's proposed new auditing standards, *An Audit of Internal Control Over Financial Reporting that is Integrated with an Audit of Financial Statements and Considering and Using the Work of Others In an Audit*, are there any areas of incompatibility that limit the effectiveness or efficiency of an evaluation conducted in accordance with the proposed guidance? If so, what are those areas and how would you proposed to resolve the incompatibility?**

The Commission writes on the bottom of page 24 to the top of page 25 that larger, more complex companies may need "employees with specialized knowledge...of GAAP, the underlying business transactions, the process activities, including the role of computer technology, that are required to initiate, authorize, record and process transactions, and the points within the process at which a material misstatement...may occur." The PCAOB's proposed auditing standard includes a requirement that the external auditor assess the competency and objectivity of those performing ICFR assessments. This extends to those who perform the control activity. If this becomes the new standard, will the Commission's statement regarding risk assessment work without the external auditor determining if those assessing risk (and by extension performing accounting oversight functions) possess adequate specialized knowledge? I believe it would, and to that end, I recommend the Commission include this assessment by the external auditor in the guidance. This guidance is hinted at on the bottom of page 29 where the Commission posits, "A control operates effectively when it is performed in a manner consistent with design by individuals with the necessary authority and competency." Furthermore, I disagree that such specialized knowledge is not required in smaller companies. Is it the Commission's argument that smaller companies' management possesses this knowledge? I believe that it is this reduced layer of oversight that opens small companies to *higher* risk.

The fourth bullet point on page 45 focuses on "complex entities in highly regulated industries." The PCAOB narrowed their proposed definition here by adding the term "large"

to describe the company. I do not believe the size or complexity of a company matters where regulations are concerned. My example to the PCAOB was a small, regional airline having trouble meeting maintenance and inspection requirements. The pressure to fly, *i.e.* earn revenue, leads management to stretch regulations to or near the breaking point. Furthermore, small cash-strapped companies may have trouble remitting sales tax or payroll withholding on time. I recommend striking the first phrase.

**7. Are there any definitions included in the proposed interpretive guidance that are confusing or inappropriate and how would you change the definitions so identified?**

I do not find any definitions that are confusing or inappropriate. I do advise interfacing with the PCAOB to ensure that their new guidance and the Commission's incorporate the same definitions of common terms.

**8. Will the guidance for disclosures about material weaknesses result in sufficient information to investors and if not, how would you change the guidance?**

The Commission offers three items to include in the disclosure starting on the bottom of page 46. I recommend that the Commission revise the third bullet by removing the words "if any." If management has no plans to remediate a material weakness, this is a bigger issue. The Commission ought not to leave this loophole.

**9. Should the guidance be issued as an interpretation or should it, or any part, be codified as a Commission rule?**

Issued guidance ought to be codified as a Commission rule in order to promote consistency among companies and auditors. This will also enhance investor confidence that individual judgment has a diminished role. (See my response to question 11 below.)

**10. Are there any considerations unique to the evaluation of ICFR by a foreign private issuer that should be addressed in the guidance? If yes, what are they?**

The Commission may find it beneficial to foreign private issuers to discuss how materiality may be impacted due to monetary exchange rates. That is, if there is an exception noted in the operation of a control, and the impact on the financial statements could be material, an investor ought to be comfortable that the assessment by management (and the external auditor) is based upon the monetary exchange rate as of the financial statement date. However, it may further benefit investors if management includes discussion of the deficiency given fluctuation in exchange rates.

**Proposed Rule Amendments** (Pages 51 and 52; 66 – 70)

**11. Should compliance with the interpretive guidance, if issued in final form, be voluntary, as proposed, or mandatory?**

For the sake of investors and comparability, I believe the Commission ought to *require* compliance with the interpretive guidance. (See my response to question 9 above.)

**12. Is it necessary or useful to amend the rules if the proposed interpretive guidance is issued in final form, or are rule revisions unnecessary?**

Which is higher in the hierarchy? If “rules” are to be followed before interpretive guidance, then the rules ought to reflect what the Commission intends through the guidance. (See my response to question 17 below.)

**13. Should the rules be amended in a different manner in view of the proposed interpretive guidance?**

The rules could be amended to direct readers to the interpretive guidance. In this way the Commission avoids having to amend the rules. Allow the rules to cover the bones and the guidance to put flesh on the bones.

**14. Is it appropriate to provide the proposed assurances in Rules 13a-15 and 15d-15 that an evaluation conducted in accordance with the interpretive guidance will satisfy the evaluation requirement in the rules?**

I would reverse the assurance. The guidance meets the requirements in the rules.

**15. Does the proposed revision offer too much or too little assurance to management that it is conducting a satisfactory evaluation if it complies with the interpretive guidance?**

I believe the proposed rules ought to—and does—provide the proper assurance to management, especially given my recommendation to mandate following the guidance.

**16. Are the proposed revisions to Exchange Act Rules 13a-15(c) and 15d-15(c) sufficiently clear that management can conduct its evaluation using methods that differ from our interpretive guidance?**

I believe the proposed revision does make this option clear. However, if the Commission wishes to provide a “safe harbor” for those companies that follow the guidance, I recommend that the guidance 1) refer to scalability while remaining in the “safe harbor,” and 2) make it clear that *not* following the guidance removes the company from the “safe harbor.”

**17. Do the proposed revisions to Rules 1-02(a)(2) and 2-02(f) of Regulation S-X effectively communicate the auditor's responsibility? Would another formulation better convey the auditor's role with respect to management's assessment and/or the auditor's reporting obligation?**

This is an area where I believe the Commission and PCAOB need to ensure that the same wording is used to describe the external auditor's responsibilities. It appears that the Commission is making the same statement. Perhaps the rules ought to refer to the PCAOB's guidance, which is focused on external auditors, and it provides specific report examples.

I am concerned that the proposed Rule 2-02(f) of Regulation S-X counters the PCAOB's concept of assessing management's work. As presented, I believe that external auditors will want to re-perform management's assessment process. Then we run into a hierarchy issue. Which guidance—the Commission's or the PCAOB's—takes precedence for external auditors. (See my response to question 12 above.)

**18. Should we consider changes to other definitions or rules in light of these proposed revisions?**

I encourage the Commission to seek opportunities to further reduce the amount of paper that would need to be created and stored. Documents can be stored electronically. The advent of SOX compliance tools that are server-based permits management to reduce the amount of paper. Costs are hefty for these software packages up front. However, the benefits are quite impressive.

**19. The proposed revision to Rule 2-02(f) highlights that disclaimers by the auditor would only be appropriate in the rare circumstance of a scope limitation. Does this adequately convey the narrow circumstances under which an auditor may disclaim an opinion under our proposed rule? Would another formulation provide better guidance to auditors?**

This is certainly narrow! Again, the Commission may better serve external auditors by referring to PCAOB guidance (once it is adopted).

**Cost-Benefit Analysis** (Pages 54 – 59)

**20. With increased reliance on management judgment, will there be unintended consequences?**

There are always unintended consequences. The external auditor must assess management's judgment. As the PCAOB has proposed, the external auditor will have to look at competency and objectivity. If the external auditor feels that personnel performing SOX testing are not competent and/or not objective, I see more work being done by the external auditor to gain comfort with the process. It may benefit external auditors to provide guidance on management competency and objectivity. For instance, work either performed by or

supervised by a person with a professional designation of Certified Public Accountant or Certified Internal Auditor, who is not a participant in a stock-based plan, provides evidence of competency and objectivity. In turn, the external auditor may place greater reliance upon this person's judgment.

**Consideration of Impact on the Economy, Burden on Competition and Promotion of Efficiency, Competition and Capital Formation** (Pages 60 – 65)

**21. We encourage the submission of comments with respect to any aspect of this Initial Regulatory Flexibility Analysis. In particular, we request comments regarding:**

- **The number of small entity issuers that may be affected by the proposed extension;**
- **The existence or nature of the potential impact of the proposed amendments on small entity issuers discussed in the analysis; and**
- **How to quantify the impact of the proposed amendments.**

There is no way for me to quantify how much money will be spent or saved. My concern continues to be that external auditors will feel compelled to perform audit procedures to gain comfort with management's work, as well as performing independent tests of controls. This will not lead to reduced auditing fees to external audit firms unless management's work is utilized. Management may have to expend for software and competent individuals to perform the work. The wild-card will be played with compensation in an effort to keep these competent persons objective in fact and appearance.

Smaller companies were already wary of costs. Delaying their full compliance requirements until after this guidance and that of the PCAOB is settled would be helpful. I would suggest that these proposals take effect for fiscal years ending on or after December 15, 2008. I discuss software tools above that are rather expensive. These smaller companies may have no choice but to use paper documentation that accelerated filers have started to leave on the shelves. Storage requirements under SOX will add some level of overhead for companies who do not use electronic document storage. I agree with the Commission that an exemption would not benefit investors, though smaller companies may opt to go private.

Respectfully submitted,

*Frank Gorrell, MSA, CPA*

Frank Gorrell, MSA, CPA