

NEW YORK  
CITY BAR

**COMMITTEE ON  
FINANCIAL REPORTING**

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NORMAN D. SLONAKER  
CHAIR  
787 SEVENTH AVENUE  
ROOM 19-112  
NEW YORK, NY 10019  
Phone: (212) 839-5356  
Fax: (212) 839-5599  
nslonaker@sidley.com

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Via e-mail

rule-comments@sec.gov  
Nancy M. Morris, Secretary  
Securities and Exchange Commission  
100 F Street  
Washington, D.C. 20549

Re: File No. S7-24-06—Management's Report on Internal Control Over  
Financial Reporting

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Ladies and Gentlemen:

This letter is submitted on behalf of the Financial Reporting Committee of the Association of the Bar of the City of New York (the "Committee") in response to Release Nos. 33-8762, 34-54976, Management's Report on Internal Control Over Financial Reporting (December 20, 2006) (the "Proposing Release"). The Proposing Release proposes interpretive guidance and rule amendments concerning the evaluation of internal control over financial reporting ("ICFR") that a registrant's management is required to conduct pursuant to Rules 13a-15(c) and 15d-15(c).

The Committee is composed of lawyers with diverse perspectives on financial reporting matters, including members of law firms and counsel to major corporations, investment banks, public accounting firms and institutional investors. A list of members of the Committee is attached as Annex A to this letter.<sup>1</sup>

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<sup>1</sup> This letter does not necessarily reflect the individual views of each member of the Committee or of the institutions with which they are affiliated.









Committee concurs with its conclusion that reporting directly on the effectiveness of ICFR is consistent with the requirements of Section 404 of the Sarbanes-Oxley Act.<sup>8</sup> The Commission should revise Rule 2-02 of Regulation S-X, and the related definition in Rule 1-02(a)(2), to reflect this change and to correspond to the content of the report the PCAOB will in fact prescribe.

The following language implements this comment and comment 5 below.

Rule 1-02(a)(2): Attestation report on internal control over financial reporting. The term *attestation report on internal control over financial reporting* means a report in which a registered public accounting firm expresses an opinion, either unqualified or adverse, as to whether the registrant maintained, in all material respects, effective internal control over financial reporting (as defined in § 240.13a-15(f) or 240-15d-15(f)). In the rare circumstance of a scope limitation that cannot be overcome by the registrant or the registered public accounting firm, the accounting firm may disclaim an opinion.

Rule 2-02(f): Attestation report on internal control over financial reporting. Every registered public accounting firm that issues or prepares an accountant's report for a registrant, other than an investment company registered under section 8 of the Investment Company Act of 1940, that is included in an annual report required by section 13(a) or 15(d) of the Securities Exchange Act of 1934 containing an assessment by management of the effectiveness of the registrant's internal control over financial reporting must provide an attestation report on internal control over financial reporting. The attestation report on internal control over financial reporting shall be dated, signed manually, identify the period covered by the report, indicate that the accountant has audited the registrant's internal control over financial reporting, and clearly state the opinion of the accountant, either unqualified or adverse, as to whether the registrant maintained, in all material respects, effective internal control over financial reporting. In the rare circumstance of a scope limitation that cannot be overcome by the registrant or the registered public accounting firm, the accounting firm may disclaim an opinion. The attestation report on internal control over financial reporting may be separate from the accountant's report.

**5. *The proposed rule amendment concerning disclaimed opinions should be revised for greater clarity***

The Committee supports the Commission's proposal to amend Rules 1-02(a)(2) and 2-02 of Regulation S-X to clarify the consequences of a disclaimed opinion on ICFR. The new language could, however, be improved to eliminate possible misreadings concerning what the "except" clause refers to, what the subsequent "which" clause refers to, and especially whether or not a report falling within the "except" clause complies with the rule. We would suggest breaking the sentence in question into two sentences, as shown in the proposed language included under point 4 above.

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<sup>8</sup> PCAOB Proposal, at 14-18.

**6. *The Commission should address the specific circumstances of foreign private issuers***

The Proposing Release asks for comment on whether there are considerations unique to the evaluation of ICFR by a foreign private issuer that the Commission should address. The Committee believes that the reconciliation to U.S. GAAP, which is required under Items 17 and 18 of Form 20-F where an issuer presents its primary financial statements under another GAAP, presents just such considerations. The Commission should make special accommodations in this area, particularly in view of the progress currently being made toward convergence of accounting principles, the prospect of possible elimination of the reconciliation requirement for IFRS reporting registrants, and the skepticism of foreign issuers and regulators about whether the Commission recognizes the impact of the Sarbanes-Oxley Act on foreign private issuers.

Specifically, the Commission should exempt the U.S. GAAP reconciliation from ICFR reporting. The reconciliation is often not integrated with the financial reporting systems on which the primary financial statements rely. The balance between issuer burdens and investor protection is also significantly different for the U.S. GAAP reconciliation than for the primary financial statements. By applying ICFR reporting to the U.S. GAAP reconciliation, the Commission has compounded the double burdens its rules impose on foreign private issuers.

If the Commission does not provide an exemption, it should specifically address in the adopting release the situation of a registrant that has material weaknesses only with respect to the U.S. GAAP reconciliation. According to Part III.B.2 of the Proposing Release, "management may state that controls are ineffective due solely to, and only to the extent of," specified material weaknesses. The Commission should add a footnote to this guidance reading as follows:

In the case of a foreign private issuer that provides primary financial statements prepared under a comprehensive body of accounting principles other than those generally accepted in the United States, management may express separately its conclusions on the effectiveness of ICFR with respect to the primary financial statements and with respect to the reconciliation required by Item 17(c)(2) of Form 20-F. Management may conclude that ICFR is effective except with respect to the reconciliation, and ineffective with respect to the reconciliation.

We welcome the guidance in note 47 of the Proposing Release, to the effect that management's evaluation process should be based in the primary financial statements. The Commission should also revise note 73 in the Proposing Release to (a) clarify that note 73 is consistent with note 47, (b) eliminate the middle sentence, which is unnecessary and could be misunderstood, and (c) edit the language slightly. The Committee's proposed revision is as follows.

Because of the importance of the reconciliation to U.S. GAAP, when management of a foreign private issuer that files in home country GAAP or IFRS determines







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