February 19, 2007

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

Via email to *rule-comments@sec.gov*

RE: File Number S7-24-06

We appreciate the opportunity to provide comments and recommendations on the SEC's proposed interpretive guidance for Management's Report on Internal Control over Financial Reporting. These comments and recommendations are offered on behalf of Hudson Financial Solutions, a practice of Hudson. Hudson is a division of Hudson Highland Group, Inc. (NASDAQ: HHGP), one of the world's leading professional staffing, retained executive search and talent management solutions providers. A $1.4 billion global organization, the company employs more than 3,800 professionals serving clients and candidates in more than 20 countries.

For the last four years, Hudson Financial Solutions as been assisting companies of all sizes comply with the internal control provisions of the Sarbanes-Oxley Act. We have found some of the biggest challenges to be the result of different expectations between management and the external audit firms. We are pleased with the efforts of the SEC to provide additional guidance related to Section 404 of the Act.

General Comments

Clearly, the SEC took care to ensure the text would be understandable by both audit and non-audit professionals alike. The document makes great strides forward in clarifying the intent of the SEC, and establishing a common understanding of the risk assessment process, testing, evidence, and reporting.

Specifically, we feel the following points within the interpretive guidance will be highly beneficial to our clients and to other companies dealing with the internal control provisions of the Sarbanes-Oxley Act:

- Clarifying the definition of material weakness. Defining the likelihood component of the material weakness definition as a "reasonable possibility"

eliminates some ambiguity related to the prior "more than remote" terminology. The prior definition could prompt companies to evaluate risks that are on the fringes of having a slightly more than remote probability of occurrence yet do not reach the threshold of being reasonably possible.

- Removing the external audit opinion on management's assessment process, and re-emphasizing that management's evaluation is based heavily on management's insight into its own business. The requirement by external auditors to evaluate management's own evaluation process has resulted in the external audit firms often second-guessing the first-hand business knowledge possessed by management, and caused many companies to expend significant effort in areas deemed low risk by management. Further emphasizing that management, and not the auditor, is responsible for determining the appropriate controls, evaluation methods, and procedures should help companies further tailor their compliance process to the unique characteristics of their business.
- Extending the risk-based approach to include documentation, testing, and evidence. The top-down, risk-based approach to scoping and prioritizing the Sarbanes-Oxley effort has allowed many of our clients to significantly reduce the number of controls considered important for internal control reporting, thereby reducing the overall cost of compliance. Recognizing differences that should exist in the level of effort required to document, validate, and provide evidence of control effectiveness makes sense in the context of the risk evaluation process, and should further realign the cost of compliance with its value based on risk.

As a whole, this additional guidance (and related modifications to previous guidance) helps to enhance the overall utility of the internal control reporting process, while better balancing the work effort associated with it.

Recommendations

Our primary recommendations are in the areas of:

- The scoping of processes, locations, and controls
- The evaluation of deficiencies
- Information Technology general controls
- Alignment with the Public Company Accounting Oversight Board's new Auditing Standard #5

We have also included in Appendix A additional responses to some of the specific questions posed by the SEC.

The scoping of processes, locations, and controls

The proposed guidance describes a risk-based approach that would require the use of judgment to determine processes and locations that are both material and pose a risk to reliable financial reporting. Management would then identify controls that address these risks, including the risk of misstatement due to fraud. Management is given significant

leeway to choose the controls upon which it will place reliance, including the consideration of effort required to test these controls in cases where multiple controls may be deemed effective at mitigating the same risk to a less-than-material level.

The SEC indicates, consistent with what we've seen at many of our clients, that the external audit firms have often heavily influenced management's own assessment process. While the proposed guidance makes it clear that the evaluation is management's assessment, and that following the methods established in the guidance is an acceptable approach, there is still a fair amount of interpretation and judgment involved in applying the risk-based approach to the scoping of key processes and locations, and subsequently identifying and validating controls. Since management has limited recourse in the event that the external audit firm disagrees with management's assessment of risk, identification of key processes, and determination of controls, it is possible that management may be forced to do more work than necessary if dealing with an overly-conservative external audit firm (or audit partner, since there is still a wide variation in approach within many of the audit firms themselves). *Note: Although the external audit opinion on management's assessment process has been removed, management has significant risk of potential failure if the external audit firm chooses to include locations, processes, or controls within its own evaluation of controls that are not consistent with those identified by management.*

> ***Recommendation**: Provide additional guidance, including supporting illustrations and examples, around the classification of high/medium/low risk processes and the identification of controls so that professionals with sufficient knowledge of the organization will rarely come to different conclusions on these elements.*

The evaluation of deficiencies

While the proposed interpretation provides updated indicators of potential material weakness, there is little tangible guidance regarding the evaluation of deficiencies. Thus far, management has had to rely upon advice from its external auditor and/or "A Framework for Evaluating Control Exceptions and Deficiencies, Version 3," which has been circulating for several years.

Clearly, management has incentive to "negotiate down" the classification of deficiencies to ensure the reporting of material weaknesses is reduced or even eliminated. Barring a common understanding and consistent framework utilized by all companies and audit firms, actual disclosures may be determined by the strength of management's negotiating team. Since the SEC intends this guidance to stand on its own, we believe additional information should be provided to ensure consistent evaluation of deficiencies by all companies reporting on management's assessment internal control.

> ***Recommendation**: Provide additional, concrete guidance surrounding the evaluation of control deficiencies. This guidance may take the form of additional frameworks/tools, enhancements to the existing "A Framework for Evaluating*

Control Exceptions and Deficiencies, Version 3" document, or validation by the SEC that the aforementioned document is the single standard for evaluating deficiencies.

Information Technology (IT) general controls

The proposed guidance provides very little additional guidance surrounding the evaluation of IT general controls, indicating that reliance on IT general controls may depend on the facts and circumstances of the organization. For many of our clients, the identification of appropriate controls surrounding information technology has been one of the more challenging aspects of the evaluation process—particularly when attempting to associate both application, application-dependent, and IT general controls back to financial reporting integrity.

In our opinion, the most serious challenge is not in demonstrating a potential link to financial reporting integrity, but rather in rationalizing and justifying the *likelihood* an IT exposure may contribute to a material misstatement to financial reporting. For example, it is clear that poor change control procedures may pose a risk that a change made to an application or related application control *could* affect the integrity of financial reporting. The challenge is in determining how likely it is that the exposure would lead to such an occurrence. We believe the lack of clear guidance associated with the linkage of IT controls to financial reporting integrity has resulted in many companies taking an ultra-conservative (and hence overly-burdensome) approach to the identification of key IT controls. In many cases, risks are being addressed in the assessment process that, while possible, are very arguably remote in likelihood (based on management's own indicators of performance, the lack of audit evidence showing specific exploitation, and limited external media-reported accounts where such exposures have indeed affected financial reporting integrity).

> ***Recommendation**: Provide additional guidance to management on assessing the risk associated with relevant IT general controls in terms of both magnitude and likelihood. Provide illustrative examples of how management can justify excluding an IT risk due to a remote probability of occurrence where specific metrics around occurrence do not exist internally or externally.*

Alignment with the Public Company Accounting Oversight Board's (PCAOB's) new Auditing Standard #5 (AS/5)

While recognizing that this interpretive guidance is intended for management, and that the PCAOB is responsible for establishing guidance regulating the external audit firms, we feel it is critical to ensure the alignment of approaches used by management and the external audit firms. When comparing this interpretive guidance to the new AS/5 proposed standard, we believe there are a number of inconsistencies. These inconsistencies include reliance on entity-level controls, alignment of the testing process with management's risk assessment, and the evaluation of deficiencies. While many of these inconsistencies are slight, we believe the SEC guidance and PCAOB guidance

should be perfectly aligned to minimize process redundancies and eliminate work that does not create value.

> ***Recommendation****: Carefully compare each section of the interpretive guidance to the PCAOB's Auditing Standard #5 and eliminate any inconsistencies. Enhance synergies between these two documents where appropriate.*

Once again, we appreciate the opportunity to comment on this exposure draft. Should you have any questions, we would be happy to discuss them with you in further detail.

Respectfully submitted,

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Hudson Financial Solutions

Appendix

The following section outlines our response to specific questions posed by the SEC. We did not provide a written response to any question about which we did not have sufficient information or a strong opinion.

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?

Yes, we believe that this guidance will help management complete the annual 404 evaluation process in an efficient and effective manner. However, we also believe improvements can be made. These improvements are addressed in the body of our comment letter.

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

Yes, we believe there are particular areas where further clarification is needed. They are described in this document.

Since the guidance states that "a company choosing to perform an evaluation of internal control in accordance with the interpretive guidance would satisfy the annual evaluation required by those rules," we also believe that it is critical that direct reference be made to this statement and this SEC guidance as a whole in the proposed PCAOB audit standard AS/5. The absence of such a reference could be detrimental to management's ability to achieve an efficient and effective 404 evaluation. Furthermore, we believe there are incongruities between this guidance and the proposed PCAOB AS/5 audit standard. These differences, if not properly resolved, could negatively affect the ability of management and attest auditors to conduct efficient and cost-effective internal control audits.

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

Yes, we believe that the guidance for disclosures about material weaknesses will result in sufficient information to investors, particularly if a consistent process for evaluating deficiencies exists within all companies reporting on internal control compliance. However, we do not believe disclosure of the details surrounding the material weakness should be elective. We believe it should be required.

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

In order to ensure the efficiency and effectiveness of the 404 audit process (including efforts by both management and the attest auditor) as described by both the Commission and the PCAOB, we believe the guidance should be mandatory when issued in its final form.

14. Is it appropriate to provide the proposed assurance 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?

Yes, absolutely.

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?

We believe, for the most part, the Commission's proposal provides the correct level of management direction other than the suggested improvements noted throughout our comments.

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?

Yes. However, allowing management to conduct a 404 evaluation in a manner different than what is described in this guidance will more than likely not result in the audit efficiencies and cost effectiveness sought by the Commission and the PCAOB.