

1 April 2005

Jonathan G. Katz  
Secretary  
Securities and Exchange Commission  
450 Fifth Street NW  
Washington, DC 20549-0609  
USA

by e-mail: rule-comments@sec.gov

Dear Mr Katz

**File Number 4-497**

**ICAEW SUBMISSION TO THE SEC ROUNDTABLE ON THE  
IMPLEMENTATION OF SARBANES-OXLEY INTERNAL CONTROL  
PROVISIONS**

I have pleasure in submitting feedback from the Institute of Chartered Accountants in England & Wales (“ICAEW”) to the SEC roundtable on the implementation of Sarbanes-Oxley internal control provisions. The ICAEW operates under a Royal Charter, working in the public interest, and is the largest professional accountancy body in Europe, with over 126,000 members in business, practice, the public and voluntary sectors and academe.

**Credentials**

The ICAEW is a major contributor to international work on internal control as evidenced by:

- our publication in 1999 of the original Turnbull guidance, *Internal Control: Guidance for Directors on the Combined Code*;
- our support to the UK Financial Reporting Council (“FRC”) in the preparation of its 2004 guide *The Turnbull guidance as an evaluation framework for the purposes of Section 404(a) of the Sarbanes-Oxley Act*;
- our project management support to the FRC’s Turnbull Review Group which is currently conducting a review of the Turnbull guidance, with any proposed changes scheduled to take effect from 2006;
- our substantial contribution to the March 2005 discussion paper *Risk management and internal control in the EU*, published by FEE, the representative body of the European accountancy profession; and

- the ongoing work of expert committees of members and practitioners in the areas of PCAOB auditing standards and corporate governance, with a sub-group dedicated to UK/US issues.

### **Observations on implementation of Section 404**

We support the overall objective of Section 404 of securing the commitment of boards, managements and auditors to effective internal control over financial reporting by establishing clear accountability. Substantial improvements in internal control over financial reporting are expected to be achieved as a result.

Nevertheless, our members who are involved in the implementation of Section 404, whether as board members, management or auditors confirm messages that you will hear from many quarters:

- the costs of implementation appear to be disproportionately high in relation to the benefits, especially for smaller entities;
- there are potentially significant unintended consequences, for example if auditors are seen as adding costly bureaucracy rather than valued judgement, the standing and attractiveness of the auditing profession, and ultimately its quality, will be diminished;
- significant levels of non-compliance will place considerable demands on registrants, in terms of disclosure and communication, and on investors, who will need to understand the significance of reported material weaknesses; and
- deferral of implementation for foreign private issuers is welcome but is no substitute for action to make implementation more practical and to provide relief from the '300 investor' rule.

In addition, the ICAEW submitted a comment letter dated 2 March 2005 in response to the Turnbull Review Group's consultation paper of December 2004. We expressed our willingness to learn from forthcoming evidence of Section 404 implementation, particularly as it relates to benefits to investors. Nevertheless, our response did not at this stage support bringing any aspects of UK practice into greater alignment with US requirements. In particular, based on experience to date in implementing Section 404, we supported retaining:

- a high level risk-based approach rather than detailed prescription;
- the existing focus on all controls rather than just controls over financial reporting;
- a private board assessment of effectiveness rather than a published statement; and
- the current level of UK auditor involvement rather than, for example, the introduction of a US-style audit covering both financial statements and internal control over financial reporting.

### **Areas for future consideration**

To summarise our initial views, the implementation of Section 404 appears to require a disproportionate investment in financial reporting. This is an important but, nevertheless, quite narrow area of corporate governance. Other aspects of corporate governance appear to escape scrutiny simply because they fall outside the remit of federal securities legislation and the SEC.

This lack of proportion is evidenced, for example, by the fact that:

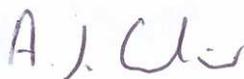
- internal control over financial reporting is only deemed to be effective if the likelihood of material misstatement is remote; and
- registrants are subject to a 'triple' audit covering their internal control over financial reporting, their related statement on effectiveness and their financial statements.

Perhaps the fundamental question facing regulators, politicians, investors and business in the United States is what needs to be done to establish a sense of proportion. Action to make implementation of Section 404 more practical would be welcome. However, any substantive reduction in the financial reporting demands placed on management by Section 404 and related audit requirements may well be dependent on more fundamental changes to build investor confidence in the accountability of management. It is noticeable that in jurisdictions such as the UK where there is little investor pressure for Section 404-type requirements, shareholders have greater rights under company law.

We trust that these comments are useful to you and we look forward to following the results of the SEC roundtable on 13 April and continuing dialogue on this important topic with SEC Commissioners and staff.

Please contact me should you wish to discuss any of the points raised in this response.

Yours sincerely



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