



March 30, 2005

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

Re: File No. 4-497

Dear Mr. Katz,

We appreciate the opportunity the United States Securities and Exchange Commission (the "Commission") and the PCAOB have provided to respond to the Commission's request for feedback regarding the implementation of Section 404 of the Sarbanes-Oxley Act of 2002 (the "Act").

Lone Star Technologies, Inc. ("Lone Star") is a NYSE-listed public company engaged principally in the manufacture and marketing of oil country tubular goods, or "OCTG", which are steel tubular products used in the completion of and production from oil and natural gas wells. We have been producing and marketing OCTG, line pipe, and other tubular products for over fifty years and currently have more than 2,400 employees and 2,600 shareholders.

When the Act was signed into law in 2002, Lone Star took immediate steps to evaluate the status of our compliance with the various requirements of the Act and where necessary, initiated processes and redirected resources to ensure that we would achieve compliance within the then proposed timelines. We understood that there would be costs associated with compliance, specifically Section 404 of the Act. However, we believed, based on Lone Star's core values and record of excellence in corporate governance and longstanding and tested internal controls, that resources spent on compliance would be minimal and in the best interests of our shareholders. Though the total direct and indirect costs of future compliance remain unforeseen, the unprecedented rapid rise in audit related costs resulting from complying with Section 404 of the Act was not anticipated.

We believe that the resulting costs of our complying with Section 404 have not been proportionate with the intended benefits. We incurred approximately \$0.5 million of advisory fees and expenses in 2003 in advance preparation for Section 404. For 2004, our initial year of compliance, we incurred approximately \$1.2 million combined for

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advisory and independent auditor fees and expenses, or approximately \$0.04 per diluted share. These amounts do not include the cost of internal time and resources expended on compliance. We understand that certain provisions within the Act placed new limitations on the types of engagements independent auditors could accept, effectively eliminating certain engagements where they historically were able to generate greater revenues per hour than from the traditional audit work. For the first-year of compliance, our independent auditors required our audit committee to accept a "blank check" engagement on the basis that they could not reasonably estimate their total time commitment due to the newness of the Act; i.e., total fee based on whatever hours were incurred instead of a fixed fee engagement as our financial statement audit had historically been. With fewer choices available of independent auditors, Lone Star had no alternative but to pay a much higher rate per hour for Section 404 compliance than the average rate of our year-end financial statement audit. Based on our independent auditor's initial estimate of expected hours, the estimated total fee for their 2004 Section 404 audit began at 50% of the total year end 2004 financial statement audit fee. However, their total Section 404 audit hours continued to grow well beyond their original estimates resulting in a total Section 404 compliance fee of nearly 200% of the 2004 year-end financial statement audit fee.

We believe that the focus of Section 404 compliance has not necessarily aligned with the Act's intended goal of improved "accuracy and reliability of corporate disclosures." Our experience with Section 404 compliance indicates to us that the design and overall effectiveness of internal controls over financial reporting are less important than the availability of physical evidence of a particular control. We view this as the "check-the-box syndrome"; i.e., a control is deemed effective not on the basis of whether the control or group of controls underlying a financial statement amount appropriately reduces the risk of an accounting misstatement to an acceptable level, but deemed effective or not effective solely, for example, on the existence of a supervisor's signature on an account reconciliation or whether the reconciliation was stamped "reviewed and approved". This is a clear departure from past auditing standards which included inquiry and observation as part of the process to obtain "sufficient competent evidential matter". We believe that the Act caused our shareholders to pay too high a price to our independent auditors for "form over substance" procedures.

The Act, which was clearly enacted in the atmosphere of reported significant management fraud and collusion, may not achieve its goals if the focus of Section 404 compliance remains on checking the box instead of on the company's overall design of its internal controls over financial reporting. Fraud and collusion do not lend themselves easily to "check-the-box" controls. The Act did, however, deal significantly with this appropriate concern by requiring the Section 302 CEO and CFO certifications be subject to criminal penalties.

Lone Star is committed to a strong internal control environment and to highly effective internal controls over its financial reporting process. We believe that it is in our shareholders' best interests to continue to fully comply with regulatory matters including compliance with Section 404. Therefore, it is Lone Star's request that the Commission

consider the following suggestions as they relates to public companies' future compliance with Section 404 of the Act:

- **Establish principles-based standards for management's assessment of its internal controls over financial reporting.** Auditing Standard No. 2 (the "Standard"), as put forth by the PCAOB, introduced substantial changes to the nature and scope of the independent audit. The audit of internal control over financial reporting greatly expanded the traditional audit process and placed new requirements on both company management and the independent auditor. However, the vast majority of the Standard's guidance for assessing internal controls over financial reporting is for the benefit of the auditor, not management. Thus, management is left preparing its assessment under a constantly changing methodology as ultimately directed by its external auditor. For Lone Star, our need to "comply" with the auditor's changing documentation and assessment requirements drove-up external and internal costs from performing redundant and unnecessary work. We believe that standards should be developed that are principles-based and that provide appropriate levels of guidance to management to effectively and efficiently assess its internal controls over financial reporting without the need to rely on the external auditor's changing interpretations.
- **Evidence of effective controls.** Under the current PCAOB Auditing Standard No. 2 and how our external auditors have interpreted this standard, proving the existence of our internal controls has placed an undue and unnecessary requirement on Lone Star. Our independent auditor's position has been, in the absence of documented evidence, controls are presumed to be ineffective. This was the most significant compliance issue for Lone Star in 2004, which diverted the majority of our internal resources for remediation. For example, although an account reconciliation was performed and a supervisor reviewed the reconciliation, without the supervisor's physical sign-off on the account reconciliation, a control deficiency would be noted. We believe a more reasonable evidentiary standard should be adopted which allows the auditors to conclude that a particular control is effective without requiring such documented physical proof.
- **Limitations on auditor's advice.** Another unintended consequence of the Act is to cause independent auditors to go to great lengths to shed themselves of audit risk by hiding behind "independence." Specifically, our auditors will no longer assist us on matters of applying existing and newly promulgated accounting pronouncements and interpretations over their concerns that they may be violating independence rules. Accordingly, if our auditors declare that we have incorrectly applied certain accounting rules (following our own conclusion), then it would result in a control deficiency. Also, if we were to seek the advice of another accounting firm other than our independent auditor, it would be viewed as "opinion shopping." We believe that no one in the United States, or globally, is in a better position to provide the appropriate guidance on accounting and reporting matters than the "Big Four" accounting firms. We believe that this position taken

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by the independent auditors will have a negative impact on the quality of financial reporting.

We appreciate this opportunity to respond to the Commission's request for feedback on Section 404 of the Act and your consideration of our comments and suggestions.

Sincerely,

A handwritten signature in black ink, appearing to read "Bryan Sinclair". The signature is stylized with a large initial "B" and a long, sweeping horizontal stroke at the end.

Bryan Sinclair  
Corporate Controller  
Lone Star Technologies, Inc.