Universal Corporation

April 1, 2005

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

Subject: File No. 4-497 – Internal Control Requirements under Section 404 of the Sarbanes-Oxley Act of 2002

Dear Mr. Katz:

In response to the Commission's request for feedback on the internal control requirements under Section 404 of the Sarbanes-Oxley Act of 2002, I am writing to express our concerns about the significant costs and burdens imposed on U.S. public companies by certain regulations under this section of the Act. Universal Corporation is a public company headquartered in Richmond, Virginia, with revenues of approximately $3 billion. We are the world's leading leaf tobacco merchant and processor, and we also have operations in lumber and building products and a variety of other agri-products businesses. Our company was founded in 1918, and has been listed on the New York Stock Exchange since 1927. Throughout our long history, we have always strived to maintain good corporate governance practices and accurate and reliable financial reporting. We believe these are fundamental components of our past success and keys to our future success. And we endorse good, balanced regulation to ensure that those qualities remain a hallmark of companies participating in the U.S. capital markets.

A number of positive changes have taken place since the well-publicized corporate governance and accounting failures of several years ago. Many of these are embodied in or arise from the Sarbanes-Oxley Act. It is worthwhile to consider just a few:

- Boards of directors and audit committees are more independent of management and are providing stronger oversight for the benefit of shareholders and other constituents of the companies they serve.

- The Chief Executive Officer and Chief Financial Officer of each public company now certify the accuracy of quarterly and annual financial statements filed with the Commission, as well as the effectiveness of the company's disclosure controls and procedures.

- Accounting firms that audit U.S. public companies now take a more independent posture with their clients. In addition to being explicitly prohibited from providing certain types of services to publicly-held audit clients, those firms are now regulated by a federal agency, the Public Company Accounting Oversight Board (PCAOB). Each firm is registered with and regularly examined by the PCAOB, and its audit workpapers for any publicly-held client are subject to surprise review at any time.

- The SEC has significantly increased its oversight of U.S. public companies, with additional examination staff in the Division of Corporation Finance, mandatory reviews of all public companies no less frequently than every three years, and increased enforcement activity.

- Various rules and interpretations have been issued to clarify or reduce the level of judgment associated with specific areas of accounting and financial reporting, to improve disclosure, and to make financial statements more transparent to the reader. These include rules issued by the private-sector standard setters (e.g., new guidance on accounting for variable interest entities; new requirements for pension and postretirement benefit disclosures), as well as guidance issued by the SEC (e.g., materiality; revenue recognition).

- High-profile dismissals of senior executives and even higher-profile criminal proceedings against some of them have reinforced the critical importance of integrity, strong corporate governance, and accurate accounting and financial reporting in both the boardroom and the back office.

On top of this significant array of changes in the regulatory and business environment, under Section 404 of the Sarbanes-Oxley Act, the Commission implemented requirements for public companies to formally evaluate and report on their internal controls over financial reporting annually, and to have their independent auditors both assess and report on the adequacy of management's evaluation and provide a positive assurance opinion on those same controls over financial reporting. At the direction of the Commission, the PCAOB developed and issued guidelines that defined the nature, timing, and extent of the work that both management and the independent auditor must undertake to complete those requirements.

Overall, we believe that most aspects of the Sarbanes-Oxley Act were useful and beneficial, helping to restore investor confidence in the securities markets at a critical time. We also believe that the intent and the initial outcome of the Section 404 requirements are positive. Surely, no company has gone through the exhaustive SOX 404 process without identifying areas where internal controls were deficient or could stand to be improved. Despite those considerations, we firmly believe Section 404 is bad regulation because it does not produce a benefit to companies, their shareholders, and the investing public that is commensurate with the substantial costs and burdens it imposes.

Our company's operations are highly decentralized. With operations in multiple lines of business and a presence in more than 35 countries around the world, the process of documenting, testing, and concluding on the effectiveness of our internal controls at key locations worldwide has been a substantial and expensive undertaking. By the time we complete our initial assessment in June, we will have spent approximately $2.5 million in third-party implementation assistance and roughly the same amount in internal staff time and resources. Those numbers do not consider the significant "reallocation" effects that the SOX 404 resource demands had on other areas of our business (e.g., delayed or curtailed projects and business activities). In addition, we will incur approximately $2.4 million in fees for the first-year internal control audit and attestation. All told, SOX 404 will cost our company almost $7.5 million this fiscal year, nearly $5 million of which represents incremental third-party costs.

Our SOX 404 costs for next year will be lower, but still substantial. Whether or not we need third-party assistance with management's assessment after the first year, we will still devote substantial internal resources to updating control documentation and performing the required tests. We expect the audit fees will decline after the first year, but they are still likely to approach $2 million on an annual basis.

We believe the requirements for the internal control assessment, as they were ultimately shaped by the SEC and the PCAOB, cannot be justified from a cost/benefit perspective. In fact, it is clear that those requirements are inconsistent with the legislative intent behind Section 404 of the Sarbanes-Oxley Act. Section 404 originated in the Senate's version of the corporate reform bill (S.2673), specifically in the deliberations of the Committee on Banking, Housing, and Urban Affairs. That Committee's report, entitled *"Report of the Committee on Banking, Housing, and Urban Affairs, United States Senate, To Accompany S.2673, Together With Additional Views"* (June 26, 2002), contains the following language:

> "In requiring the registered public accounting firm preparing the audit report to attest to and report on management's assessment of internal controls, the Committee does not intend that the auditor's evaluation be the subject of a separate engagement or the basis for increased charges or fees."

Despite the clearly stated intent of the Congress, public companies have had to spend hundreds of millions, if not billions, of dollars to implement SOX 404. Going forward, they will spend further millions each year unless the SEC acts now to reduce this burden and realize the intent of Congress.

Ultimately, the significant costs of complying with SOX 404 are attributable to PCAOB Standard No. 2 and the related guidance that followed it. The requirements established by the PCAOB and the SEC have driven the internal control evaluation to the extreme. The independent audit firms are interpreting all PCAOB and SEC guidance in a self-protective fashion. Instead of being expected to maintain a system of internal controls designed to provide "reasonable assurance" that financial statements are free from material error, companies are now being held to standard that approaches "absolute assurance", in order to ensure that the auditors' workpapers pass muster with the PCAOB examiners. For years, the domain of auditors has been the job of auditing a company's financial statements, primarily a process of verifying the accuracy and fair disclosure of historical transactions. The internal control evaluation, on the other hand, is almost entirely a judgmental process, requiring an overwhelming amount of time for the audit team to analyze, understand, discuss, deliberate, and ultimately make a conclusion on both the design and effectiveness of hundreds or even thousands of individual controls in place in each and every public company. A reasonable, balanced perspective is lost in the details of the audit. The result is millions of dollars of unwarranted costs to public companies, who must try to pass them along to customers, look for ways to offset them (perhaps by transferring U.S. jobs to lower wage countries or reducing corporate philanthropy), or accept diminished returns for their shareholders. Despite the seriousness of the corporate governance and accounting failures that led to the Sarbanes-Oxley Act, the great majority of U.S. public companies are well-managed and control conscious, have no history of such failures, and pose no significant threat of them in the future. Those companies and their shareholders are paying a heavy price that simply is not justified by the results.

Although the ultimate SOX 404 requirements were neither representative of legislative intent nor justifiable from a cost/benefit perspective, we nevertheless view the work product we have created as an asset to our company. We intend, and at this time are obviously required, to maintain the value of that asset by regularly updating the documentation and ensuring the continued effectiveness of our internal controls through periodic testing. However, <u>we feel very strongly that the requirement for an annual independent audit of internal controls should be eliminated</u>. First, as mentioned earlier in this letter, the significant changes in the regulatory and business environment over the past few years have greatly improved governance practices and financial reporting. Secondly, the requirement for two internal control evaluations (one by management and one by the auditor), coupled with extensive substantive audit procedures in the independent audit of the financial statements, is excessive. Finally, significant improvements to a company's internal controls (which are ultimately what benefits shareholders and investors) are largely a first-year issue. If the requirement for the independent internal control audit was eliminated tomorrow, we have no doubt that most companies would strive to maintain the control improvements made over the past two years.

We think a more balanced approach at this time would be to eliminate the internal control audit and leave in place the requirement for management to conduct an annual internal control evaluation and report on it in the Form 10-K. The requirement for an independent audit of controls is better placed in the SEC's enforcement regime, perhaps by providing the Division of Enforcement with the power to impose it for a specified period of time on companies that are determined by events, investigations, or routine examinations to have control deficiencies that are severe enough to warrant it.

Until reform is achieved, which may require Congressional action, we encourage the Commission and the PCAOB to re-examine the requirements they have imposed under SOX 404, listen to and act on the valuable input that many constituents will provide during this comment process and at the roundtable forum, and seek ways to lessen the substantial cost and burden of this regulation on the majority of fine public companies that share the ideals of good corporate governance and accurate financial reporting.

We appreciate the opportunity to share our comments on the internal control requirements under the Sarbanes-Oxley Act of 2002. We would be happy to discuss our views further as the Commission continues to evaluate this critical area.

Sincerely,

Robert M. Peebles

Robert M. Peebles
Controller