May 1, 2006

Mr. Christopher Cox, Chairman
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC  20549

Mr. William Gradison, Acting Chairman
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, DC  20006

Filed electronically at rule-comments@sec.gov

Re:   File Number 4-511

Dear Mssrs. Cox and Gradison:

The Edison Electric Institute (EEI) is submitting the following comments on
implementation of Section 404 of the Sarbanes-Oxley Act of 2002 in response to the
Commission’s notice inviting comments published in the Federal Register on March 3,
2006, at 71 Fed. Reg. 11001. We hope that these comments will assist the Commission
and the Board in seeking improvements in implementation of Section 404, in particular to
make implementation of the section more efficient, less burdensome, and better focused
on issues of material concern.

If you have any questions regarding these comments, or need additional information,
please contact me at the above phone number, or contact either of the following EEI staff:
David Stringfellow at 202/ 508-5494, or Henri Bartholomot at 202/ 508-5622.

Respectfully submitted,

- signature -

David K. Owens
The Edison Electric Institute (EEI) respectfully submits these comments to assist the Securities and Exchange Commission (SEC or the Commission) and the Public Company Accounting Oversight Board (PCAOB or the Board) in framing issues for discussion at the May 10, 2006 Section 404 roundtable and in making further improvements to implementation of Section 404. The roundtable will focus on second-year experiences with the reporting and auditing requirements of Section 404 of the Sarbanes-Oxley Act of 2002 related to companies’ internal control over financial reporting.

We appreciate the opportunity to comment on Section 404 implementation again. We submitted comments on Section 404 issues on March 31, 2005, in anticipation of the Commission and Board’s first roundtable held on April 13, 2005. We have noted some positive progress since then, including the Board’s May 16, 2005 guidance, which encouraged external auditors to use reasonable approaches to implementing Section 404. We hope that these comments will provide the Commission and the Board with helpful suggestions for further improvements in implementation of Section 404.

EEI’S INTEREST IN THIS PROCEEDING

EEI is the association of the United States shareholder-owned electric companies, international affiliates, and industry associates worldwide. Our U.S. members serve 97 percent of the ultimate customers in the shareholder owned segment of the industry, and 71 percent of all electric utility ultimate customers on the nation, and generate almost 60 percent of the electricity produced in the United States.

Many of EEI’s members are registered with the SEC as publicly-held companies and as such are subject to Section 404 and the Board’s rules and guidance for implementing it. Furthermore, a number of our members, especially parent companies, are among the “accelerated” filers who have been required to comply with the Board’s Section 404 assessment and reporting requirements for the past two years. As a result, EEI has a direct interest in implementation of Section 404.

Our members have found the Section 404 assessment, auditing, and reporting process to be more burdensome than necessary and less well focused on significant issues of
concern. In these comments, EEI draws from that experience to offer suggestions on ways to improve the Section 404 implementation process.

**OVERVIEW OF EEI’S RECOMMENDATIONS**

EEI encourages the SEC and PCAOB to help keep the Section 404 process as efficient and reasonable as possible. We recognize and fully support the intent of Sarbanes-Oxley and Section 404 to ensure that company financial statements provide sufficient, accurate information to investors so investors can make informed decisions about their investments. EEI members have a long history of complying with complex federal and state requirements for keeping detailed records of their income, expenses, assets, and liabilities, and for reporting to investors and regulatory agencies about these matters. Given this experience, we offer the following general suggestions.

1. **The SEC and PCAOB should provide an exemption from Section 404 for certain subsidiaries**, namely ones that are substantially owned by parent companies subject to Section 404, and ones that are exempt from the SEC’s internal audit committee requirement because they do not have registered securities.

2. **The SEC and PCAOB should require audit firms in implementing Section 404 to focus on issues of material concern** to investors using risk-based analysis, not issues that are unlikely to have material impacts on the completeness or accuracy of financial reports. The goal should be reasonable assurances rather than perfection. In this regard, one area of concern is whether external auditors have placed too much emphasis on information technology general controls.

3. **The SEC should review whether the reporting of “material changes” under Regulation S-K section 209.308 unnecessarily duplicates Section 404 reporting, and the Commission should at least clarify and focus this reporting requirement.**

4. **The SEC and PCAOB should promote and support use of reasonable, best professional judgment by external auditors**, rather than creating a climate in which the auditors feel compelled to focus on unimportant details or to use worst-case analyses. For example, the absence of documentation of a control should not equate to lack of the control, if a company can demonstrate that the control is in place and operating appropriately. Similarly, inventory audits should use reasonable, sampling-based approaches consistent with statistical sampling guidelines available to auditors.

5. **The SEC and PCAOB should encourage external auditors to rely on competent, objective work performed by others, not just work performed by internal company auditors.** The test should be whether the work appears to be reliable to the external auditor. This would help to avoid unnecessary duplication of effort. Also, the Commission and Board should provide reasonable guidance to management as to the extent of testing management must perform in order to conclude its assessment and enable external auditors to rely on this work.
The SEC and PCAOB should promote selective, rotational testing of internal controls spread out over time and should allow late-in-year changes in controls without producing qualified audit reports. Specifically, the Commission and Board should impress on external auditors that (a) testing in a given year should focus on key control systems that have changed within the year and are significant to a company’s financial reports, and need not be undertaken each year for systems that are routine, low risk, or static, (b) testing can and should be spread out during the year and from year to year, and (c) late-adopted changes in company control systems can be tested in the following year without the need to qualify auditor statements, or at least can be reviewed using interim testing or testing that a company has performed.

The SEC and PCAOB should strengthen and promote reliance on the Board’s May 2005 guidance, which recommends some reasonable approaches to implementing Section 404. EEI members are hearing from their external auditors that the auditors fear being held to a tougher standard by the PCAOB when the auditors themselves are audited by the Board. The Board and Commission should provide assurance that external auditors can fully rely on the guidance and will not be second-guessed during later PCAOB audits.

EEI’S RECOMMENDATIONS

1. Exempt Substantially Owned Subsidiaries and Subsidiaries Without Registered Securities from Separate Section 404 Requirements

EEI supports the Commission and Board’s efforts to improve the financial reporting of publicly traded companies. We believe that implementation of the Sarbanes-Oxley Act has improved corporate governance and financial disclosure in this country. Our publicly traded members have successfully complied with Section 404 as accelerated filers at the parent level for the years ended December 31, 2004 and 2005.

However, the deadline is approaching for non-accelerated filers to begin complying with Section 404, starting with the year ending December 31, 2007. A whole new suite of companies will face filing requirements under this deadline, including subsidiaries of parents that already have met the Section 404 requirements. EEI encourages the Commission and Board to modify their Section 404 requirements to exclude two categories of these subsidiaries.

First, EEI encourages the Commission and Board to exempt substantially owned subsidiaries of a parent that is subject to the Section 404 requirements (e.g. where the parent owns 95% or more of the subsidiary) from separate Section 404 auditing and reporting requirements. This would reflect that parent companies exercise control over their subsidiaries and already assess financial controls throughout the overall company in order to satisfy Section 404. Furthermore, in our industry, most of these subsidiaries are heavily regulated public utilities.
Requiring the subsidiaries to comply separately with Section 404, in addition to compliance by their parents, will result in internal and external costs that will far exceed the additional benefits if any for company investors and other stakeholders. Given that governance and financial oversight of substantially owned subsidiaries are handled by the parent company, Section 404 assessments and attestations at the subsidiary level are redundant to those done at the parent level. Applying Section 404 to the subsidiaries will duplicate the auditing and reporting requirements applicable to the parent companies. Further, applying the section to the subsidiaries will not provide sufficient additional benefits in terms of improved financial reporting and fraud risk mitigation to justify the substantial additional costs. By the very nature and size of subsidiaries, applying Section 404 to them will involve much lower levels of materiality than for the parent companies.

Second, the SEC and PCAOB should exempt from separate Section 404 compliance subsidiaries that do not have registered securities. The SEC already has granted an exemption from the audit committee requirement for such subsidiaries. The rationale for this exemption is provided in SEC Release No. 33-8220; 34-47654, “Standards Relating to Listed Company Audit Committees,” dated April 9, 2003, under the heading, F2, Application and Implementation of the Standards, Securities Affected, Multiple Listings. A comparable exemption should apply to the provisions of Section 404. The purpose of Section 404 is to ensure that financial information provided to investors in publicly-traded companies is based on accounting systems with proper controls and management oversight. Therefore, Section 404 should not be applied to companies without registered, publicly-traded securities.

Without relief in these two areas, such subsidiaries will face significant costs to implement Section 404 beginning with years ending December 31, 2007, with little corresponding benefit from a risk mitigation perspective. In turn, these costs would likely be borne by company shareholders and customers, the latter of whom could face higher bills due to the Section 404 compliance costs.

2. **Focus Section 404 Implementation on Issues of Material Concern**

   **A. Information Technology**

   EEI recommends that the Commission and Board examine implementation by external audit firms of Section 404 in the context of information technology (IT) general controls. External audit firms have been imposing in-depth testing and other detailed requirements for these controls. This has made Section 404 compliance extremely burdensome to company IT organizations and has even forced some companies hire outside firms to assist with the reviews. Furthermore, the burden has often been out-of-proportion to the benefits because IT controls have not often resulted in material weaknesses.

   At a minimum, as we will discuss in the testing section of these comments below, the Commission and Board should allow cyclical or rotational testing of IT controls and
should focus the scope and extent of testing of the controls to keep the review in proportion to the risk involved. We believe that the Commission and Board could reduce the currently required scope of IT general control reviews without significantly increasing risks that would impact financial reporting.

Furthermore, the Commission and Board should examine alternatives for addressing data base administrator (DBA) access to production databases and data, an issue raised during last year’s roundtable. DBA access is essential to ensure that IT general controls are properly in place and operating. But some external auditors continue to view this very normal scenario as a “control deficiency” because clients cannot prove that DBA access is directly monitored. Clients have referred to other IT general controls and controls at the business process level to provide assurance and comfort to the external auditors. However, the auditors have viewed these as being only “mitigating controls.” Additionally, the auditors have appeared to disregard other aspects of the IT control environment, existing change controls, etc. in concluding whether DBA access to production was a control deficiency.

Similarly, the Commission and Board should review handling of technical support identifications (IDs) for production applications, also known as "firefighter IDs" or "emergency IDs.” Again, some external auditors have raised concerns when clients could not track the IDs for routine maintenance and fixes, viewing the IDs as being "high risk” to the financial statements because logging of the IDs could not be initiated or monitored. However, client acceptance and approval of changes made by the IDs existed in addition to business process controls.

The overarching position that the external auditors have taken is that IT general controls are pervasive and can impact all aspects of financial reporting. But this position ignores the supporting role that IT general controls play, and it ignores the mitigating controls that companies have in place to ensure the accuracy and validity of financial statements.

To address these concerns, the Commission and Board should clarify that external auditors need to keep the role of IT general controls in proper perspective as a supporting function that may have relatively low independent risk to the financial statement. In addition, the Commission and Board should describe the reasonable extent that companies should document and test IT general controls and the extent of reliance that can be placed on mitigating controls. Again, the guidance should allow for cyclical or rotational testing, focus the scope and extent of testing of IT general controls, and clarify evidence required to demonstrate effectiveness of the IT controls. We also request guidance as to how the top-down approach should be applied to evaluating IT general controls and any deficiencies therein.

B. Immaterial Items

The PCAOB’s Release 2005-23 dated November 30, 2005 (“November release”), related to Auditing Standard No. 2 (AS 2), acknowledged that an audit in accordance with AS 2
should not be designed to detect deficiencies that are less severe than a material weakness. Yet we are aware of situations where immaterial deficiencies are being documented and reported to management and the audit committee as Sarbanes-Oxley control deficiencies even when the transaction cycle was considered below scope for Sarbanes-Oxley testing.

In many cases the only supporting evidence of a deficiency is a passed audit adjustment (i.e., internal and external judgment has deemed the item as not material to the financial statement audit opinion). Such a narrow focus on these types of immaterial items leads to unnecessary efforts by companies and their auditors and undercuts a more appropriate focus on ensuring that key, material controls are in fact in place and operating. The message to line personnel becomes everything is material, and they are unable to focus upon imbedding appropriate control philosophies.

EEI requests that the SEC and PCAOB reiterate and provide additional guidance that an audit designed in accordance with AS 2 should not be designed to detect deficiencies that, individually or in the aggregate, are less severe than a material weakness. In fact, the Commission and Board should explicitly exclude from AS 2 low-risk areas of a company’s financial control system. Significant time is being consumed by both the issuers and the audit firms addressing items of a lesser nature.

3. **Review Reporting of Changes Under Regulation S-K**

Section 209.308 of Regulation S-K requires the reporting of material changes that impact internal controls over financial reporting. However, this requirement appears to duplicate the reviews and disclosures provided under Sarbanes-Oxley Section 404, in particular through management assessments and auditor reviews. Furthermore, the lack of clarity of reporting under Regulation S-K has caused confusion and unproductive work for many companies. Many disclosures related to this requirement appear to go beyond truly material changes. For example, companies have made disclosures about extraordinary accounting transactions, changes in enterprise risks, potential litigation, and changes of an operational nature. The disparate nature of these disclosures suggests that confusion exists and leads us to question the value of the disclosures to investors.

To avoid duplication and to eliminate confusion, the SEC should consider removing the separate Regulation S-K requirement. If, however, the SEC retains the requirement: (a) the SEC should provide more detailed guidance that would explain the intent and purpose of the disclosure and should provide specific criteria and examples to help companies identify the changes to internal controls that would be classified as material; and (b) the SEC should clarify that companies are required to report only material changes that have a negative impact on internal controls over financial reporting, though companies may wish to report positive changes especially if coming off of a material weakness.
4. **Emphasize that External Auditors Should Apply Section 404 Reasonably, Using Best Professional Judgment, Not Worst Case Scenarios**

   **A. Documentation**

   External auditors appear to apply a worst case scenario in determining whether a control is in place and operating effectively. Specifically, if a control is not fully documented, the auditors often will assume that the control does not exist, thus frequently overstating the potential financial reporting error that could occur as a result of the control "failing." This approach has been applied to, among others, application/data base access issues. In turn, it has promoted documentation for the sake of documentation rather than based on significant risk to investors. This focus on documentation has taken the focus away from the real issue, namely whether key controls are in place and operating effectively.

   EEI encourages the Commission and Board to clarify that documentation requirements should be reasonable and should recognize the need for companies to focus primarily on business efficiency rather than audit efficiency. The important issue is that the investors are informed whether controls are operating effectively. This requires reasonable documentation, not rigid and exhaustive documentation requirements.

   In addition, we encourage the Commission and the Board to specify that the lack of documentation even for a key control does not represent a control deficiency if the key control is in operation and simply was not documented. If the actual key control is operating effectively and the company can demonstrate the control is working, the audit opinion should not be affected.

   **B. Inventory Reviews**

   Some utilities experienced natural disasters or other abnormal service interruptions in their service territories during 2005. These events caused some controls to be temporarily postponed, primarily in the area of inventory. Wall-to-wall physical counts were performed in order to gain comfort over the ending inventory balance. Yet, in some cases, external auditors applied stringent thresholds approaching a 99% accuracy rate over inventory counts. One methodology employed included selecting and validating 65 items from count sheet to storeroom floor and 65 items from storeroom floor to count sheet. Any error that exceeded 2 deviations could require a recount of the entire storeroom, though the auditor did consider the nature of the item being counted. For example, the deviation rate for counting bolts was higher than the deviation rate for counting transformers. This methodology was construed as a "statistical approach" to validating the accuracy of inventory counts and is presented as the norm adopted by the "Big 4" firms. We are concerned that such a stringent approach to inventory review is neither reasonable under the circumstances, nor in keeping with professional guidance on the use of statistical measures for conducting audits. We certainly would not want such stringent approaches used to conclude that a control deficiency exists.
EEI advocates that a more reasonable approach to inventory validation is needed, allowing management to apply estimates based on the information known at the time regarding inventory valuations as opposed to requiring wall-to-wall physical counts that are conducted during compressed time periods.

5. **Promote Reliance on the Competent Work of Others**

In its May 2005 guidance, in Questions and Answers No. 46-49, the PCAOB stated that auditors should take advantage of the significant flexibility that the Board’s Section 404 standard allows to use the work of others to reduce redundant testing. The Board also indicated that auditors were not using the work of others to the extent permitted by AS 2. However, the guidance focuses on work performed by internal auditors, not others within a company. Furthermore, external auditors do not appear to be relying on work performed by corporate internal auditors and others, even when that work is competent and reliable, because of the lack of guidance encouraging them to rely on such work.

As a result, external auditors are duplicating the work of internal auditors and management, producing unnecessary inefficiency and wasting limited resources. EEI hopes that the SEC and PCAOB can help reduce this duplication of effort by encouraging external auditors to place greater reliance on competent work performed by company personnel, including management and internal auditors.

If a company can demonstrate that self-assessment testing and other work has been done objectively and with adequate oversight, external auditors should rely on this testing and other work. By emphasizing that external auditors can rely only on internal audit testing, the SEC and PCAOB encourage companies to keep the testing effort in their respective audit groups, which de-emphasizes ownership by control process owners. A self-assessment model would encourage control owners to understand their control environment and monitor it regularly on an ongoing basis rather than waiting for internal auditors to come test controls once a year.

Therefore, EEI encourages the Board either to modify AS 2 or to provide explicit guidance that allows and encourages external auditors to rely on the work performed by others, including company management and staff and not just internal auditors, provided the auditors are comfortable that the work has been done competently and objectively. External auditors should specifically rely on competent work by company management and staff as to financial reporting, computer and IT controls, controls in low risk areas, and testing of controls, including walk-throughs.

Further, the rule changes or guidance should explicitly address the reasonable extent of testing that management must perform in order to conclude its assessment and enable the external auditor to rely upon this work. This would help provide management with greater certainty that work a company undertakes will not be wasted or later duplicated by external auditors.
6. **Encourage Selective, Rotational Testing and Allow Late-in-Year Changes**

   **A. Rotational Testing, a Risk-Based Approach**

The PCAOB’s rules state that each year’s audit must stand on its own. Although the Board’s May 2005 guidance, in Question & Answer No. 44, indicates that audit knowledge obtained in prior years should not be ignored in subsequent years’ audits, the guidance does not sufficiently encourage targeted, risk-based techniques such as rotating tests of controls over a number of years. As a result, the rules tend to govern, leading external auditors to require that each control or key control must be extensively tested every year.

However, this approach results in excessive, unnecessary testing. While such rigorous testing of key controls may be needed in the first year of implementing Section 404 to provide a baseline, auditors should be encouraged not to repeat such broad testing of controls in subsequent years.

Instead, the SEC and PCAOB should strongly encourage auditors to focus primarily on testing key controls that have changed during the year, where the changes are likely to have a significant impact on financial statements. Beyond that, if auditors are inclined to test other controls, they should do so only as warranted, on a rotating basis. In particular, such selective, rotational testing should be used for controls that are relatively static, low risk, or routine, as well as in areas where a company has demonstrated historically strong and effective controls. This approach would be consistent with the PCAOB’s May 2005 guidance as to use of benchmarking for testing automated application controls.

Furthermore, the Board should specify that auditors can rely on testing performed earlier in a year or in prior years, as long as the control tested has not significantly changed. This would encourage auditors to allow testing throughout a year and from year to year, thus spreading out the testing requirements and avoiding year-end spikes in the testing workload.

   **B. Late-in-Year Changes**

AS 2 paragraphs 147-151 state that the auditor’s opinion reflects internal control over financial reporting as of a point in time and taken as a whole, thereby requiring the auditor to obtain evidence that internal control over financial reporting has operated effectively for a sufficient period of time. The May 2005 guidance, in Question and Answer No. 52, states “it would be inappropriate for the auditor to conclude, as a rule, that management should not implement changes to IT for some arbitrary period of time before year end.” However, for some EEI members, external auditors have continued to indicate that if a control has not operated for a requisite period of time, the companies and the auditors cannot rely on the operating effectiveness of the control.

As a result, companies often avoid making changes in important business processes and systems for an extended period (up to six months in the case of a quarterly control that is
required to run for two quarters) rather than risk a scope limitation or deficiency designation from their external auditors. In turn, by effectively discouraging such changes, AS 2 is interfering with the practicality of running businesses and is preventing companies from making changes that would produce economic benefits and more efficient operations. Moreover, it is discouraging companies from implementing new technologies that could actually improve the control environment.

To remedy this situation, EEI encourages the SEC and PCAOB to specify that such late-in-year changes in control systems can be tested the following year, and meanwhile external auditors can issue opinions with “no material weaknesses” stemming from such changes. At most, if warranted, the auditors should simply note the late-in-year change has not yet been tested, as a “scope limitation” rather than as a material weakness in their opinions. This approach is similar to the approach used by the SEC in the context of late-in-year mergers and acquisitions. In that context, the SEC allows management to exclude an acquired business from scope if there is insufficient time to complete an assessment of internal controls, provided the reviews are undertaken in the following year. Such an approach in the Section 404 context would encourage companies to make improvements in their processes and systems at any time, without fear of triggering a qualified opinion because the improvements come too late in the year.

At a minimum, the SEC and PCAOB should clarify that external auditors can rely on: (a) interim internal control audit testing as to late-in-year changes, whether performed by the external auditor, internal auditor, or management; and (b) year-end internal control audits by company management as to such changes, while the external auditor is simultaneously performing substantive financial statement audits. By promoting reliance on such work, the Commission and Board would help avoid discouraging late-in-year improvements in control systems.

7. **Strengthen and Promote Reliance on the May 2005 Guidance**

Companies often refer to the PCAOB’s May 2005 guidance when discussing control issues with their external auditors. But it has been our members’ experience that the external auditors often point to the rigors and fear of a PCAOB examination, instead of the published guidance, and express concern about "not doing enough" or "testing enough controls" and subsequently receiving an adverse PCAOB audit opinion. In other words, the external auditors appear to hedge their PCAOB audits by requiring their clients to document or test more controls than necessary and by taking extreme and often overly conservative views of evaluating control deficiencies. In turn, EEI members are bearing increased costs the fear of PCAOB review has resulted in unnecessary procedures.

External auditors are stating that even though the revised guidelines appear less stringent, the auditors are still being held to rigorous standards by the PCAOB’s own audits of them and that the requirements imposed on the external auditors have not become less stringent in accordance with the revised guidelines. For example, the May 2005 guidance stressed the importance of tailoring the audit using a risk-based approach placing more emphasis
on high risk areas over low risk areas. But the guidance still states that all areas should be tested and included in the scope of Sarbanes-Oxley reviews. As a result, the recommendation to use a risk assessment approach did not result in a significant amount of change in the audit approach taken by external auditors.

Because of this, companies are being required to do substantially more reviews and documentation than the guidance appears to require, creating unnecessary company workload. Furthermore, any efficiencies gained in processes from multi-year experiences are being offset by additional efforts to document risk assessments. We concur with the risk focus of the May 2005 guidance, but we need to have tools to reduce or eliminate work in low risk areas and to leverage the risk based work.

The PCAOB’s May 2005 guidance and November release related to implementation of AS 2 contained useful clarification of many aspects of the application of AS 2. The additional guidance should have created efficiencies in the audits of internal controls for fiscal years ended in 2005. However, as just discussed, in practice, external auditors have not modified their approaches to incorporate this guidance.

Therefore, EEI recommends that the PCAOB strengthen and reiterate several points made in the May 2005 guidance and November release such that the intended efficiencies can be achieved. Areas where further efficiencies can be gained include:

- Integration of internal control audits with audits of financial statements – Redundant testing, particularly during the year-end closing and financial reporting process, can be particularly inefficient.

- Use of a top-down, risk-based approach – The level of focus on a lower risk area should be different than that of a higher risk area.

- An audit of internal control over financial reporting should be designed to provide reasonable assurance as to whether material weaknesses exist – Performing tests to find anything that aggregates to less than a material weakness or to obtain absolute certainty is inefficient.

- In classifying possible misstatements, “more than remote” means “at least reasonably possible” – The intent is to determine what a “prudent official” would conclude. The evaluation of possible misstatements involves a qualitative assessment, not just reliance on a mechanical, quantitative approach.

- In the May 16, 2005 guidance and subsequent report issued on November 30, 2005 the Board explicitly states in many areas that the auditor use “Professional Judgment” in their planning and evaluations and not always rely on checklists and/or frameworks. This should continue to be reiterated especially in the area of evaluating deficiencies. The use of frameworks rather than unguided professional judgment would lead a more efficient and effective process.
CONCLUSION

EEI appreciates this opportunity to provide comments to the SEC and PCAOB about opportunities for further improvements in implementation of Sarbanes-Oxley Section 404. We appreciate the work the Commission and Board already have undertaken to streamline compliance with Section 404.

We encourage the SEC and PCAOB to exempt from Section 404 regulations subsidiaries that are substantially owned by parents which themselves must comply with Section 404 and subsidiaries that do not have registered securities. This would avoid unnecessary duplicative effort by parents and their subsidiaries and compliance by subsidiaries that do not have publicly-traded securities.

We also encourage further efforts to ensure that the Section 404 reviews of financial controls performed by company management and internal and external auditors are as efficient as possible. In particular, we fully support use of a risk-based approach to evaluating the controls – low risk areas should either be exempted or de-emphasized, and the Commission and Board should promote use of rotational testing for low-risk or static areas, so the emphasis can properly be on significant controls that have changed and are likely to affect financial reporting. In addition, we encourage the Commission and Board to promote reliance on prior reviews when valid, controls that actually are in place even if not fully documented, other persons’ work if competently performed, most-likely rather than worst-case scenarios, and other such measures to keep the Section 404 reviews and reporting focused and efficient. We also encourage the Commission and Board to recognize the substantial burdens that Section 404 reviews and reporting can impose on companies, in particular if pushed to year’s end, and to look for ways to minimize the burden, again with an eye on value of each requirement to the investor.