

CHAMBER OF COMMERCE
OF THE
UNITED STATES OF AMERICA

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May 3, 2006

Ms. Nancy M. Morris
Secretary
Securities and Exchange Commission
Washington, DC 20549-1090

Public Company Accounting Oversight Board
Attention: Office of the Secretary
1666 K Street, NW
Washington, DC 20006-2803

Re: Internal Control Roundtable and File Number 4-511

Dear Sir or Madam:

The U.S. Chamber of Commerce is the largest business federation in the world, representing the interests of some three million companies of every size and industry. We appreciate the opportunity to submit a comment letter in connection with the SEC and PCAOB Internal Control Roundtable scheduled for May 10, 2006. We also appreciate the willingness of the SEC and PCAOB to accept Robert W. Davis, Executive Vice President and Chief Financial Officer of CA, as the Chamber's representative at the Roundtable.

In developing these comments, the Chamber has been informed by a roundtable it held with member company CFO's and other interested parties on March 30, 2006. In addition, the comments set forth below build upon our letters to the SEC of April 12, 2005, October 24, 2005 and April 3, 2006, in addition to numerous conversations with SEC and PCAOB staff.

Overview

Over the course of the last year, we have appreciated the willingness of SEC and PCAOB staff to listen to concerns regarding the implementation of Section 404 of the Sarbanes-Oxley Act of 2002 (“SOX 404”) and Auditing Standard # 2 (“AS# 2”). Further, we do believe that some progress has been made as both issuers and auditors gain experience with the relevant requirements¹. However, the bottom line is that SOX 404 is still being implemented in a way that places unnecessary burdens on companies wishing to make their securities available in the United States, and these burdens are disproportionate to any benefits that can reasonably be identified. The SEC and PCAOB have a primary obligation to bring this cost/benefit equation into balance and maintain the long-term health and competitiveness of our capital markets.

The Chamber maintains the view that the SEC and PCAOB can resolve most, if not all, of the issues presented by the implementation of SOX 404 through regulatory action. However, the current implementation regime has been in place for two years without improvement in several areas, and we believe that without appropriate regulatory action Congress may soon feel the need to intervene.

The most important challenges implementing SOX 404 persist despite determined efforts by internal and external auditors to learn from the first year’s implementation and despite helpful additional guidance issued by the SEC and PCAOB after last year’s roundtable. We believe both the SEC and the PCAOB should take immediate steps, including, at a minimum, delaying any application of SOX 404 to non-accelerated filers until implementation of SOX 404 is fixed.

As described further below, we propose the following specific recommendations:

- Clarify AS# 2 and provide better guidance to auditing firms and their clients regarding the appropriate application of the terms in that standard and the level of review and testing required by it.

¹ As an example, in a recent survey by Financial Executives International 68.4% of responding companies agreed that their auditors had engaged in directly and timely communication (either strongly agree or somewhat agree), and 62.7% agreed that their auditors had integrated their audits of internal control with their audits of their financial statements. http://www.fe.org/news/404_survey_4_6_06.cfm

- The SEC must issue its own internal control standard that is directly applicable to issuers. The PCAOB has no mandate to be the de facto regulator of issuers with respect to internal controls.
- Greater focus must be given to the appropriate standards for the documentation and testing of IT systems. In particular, real analysis needs to be done on the relative importance of access controls and the testing costs incurred in examining those controls.
- Greater focus needs to be given to the review and testing of significant entity-level controls, as opposed to individual transaction-based controls.
- The SEC needs to reexamine its standards for financial statement restatements. When 8.5%² of all public companies are required to restate their financial statements in any given year— particularly in the current environment of newly energized boards and audit committees— then that says more about the standard for restatements than it does the financial statements themselves.

Discussion

Cost/Benefit Balance

Considerable recent media attention has been paid to the issue of direct costs of SOX 404 and, in particular, whether those costs are declining significantly over time³. Rather than weigh-in with various competing statistics, we would offer two notes of caution.

² As announced on March 2, 2006 by Glass, Lewis & Co.

<http://www.glasslewis.com/downloads/Restatements2005Summary.pdf>

³ The survey by Financial Executives International that found that the total average cost for Section 404 compliance for accelerated filers was \$3.8 million during fiscal year 2005, down 16.3% from 2004. In addition, a recently published survey sponsored by the four major accounting firms and conducted by CRA International found that total 404 costs has declined by 44% on average for larger companies and 31% for smaller companies.

http://www.s-oxinternalcontrolinfo.com/pdfs/CRA_III.pdf

First, there are at least four separate components of the overall cost presented by SOX 404. There are the outside auditor costs, which receive the most public attention. There are also external consultant costs and the costs of additional internal audit and compliance functions. Finally, there are substantial “soft costs” associated with additional demands for management time and attention. Even without regard to the “soft costs,” we have been informed by our members that a large portion of any savings from reduced outside auditor and consultant costs over time has been redirected towards additional expenditures on internal capabilities. Therefore, one needs to examine the entire scope of additional costs placed on companies in complying with SOX 404 over the long-term.

Second, and more important, costs can only be examined in the context of a cost/benefit balance. Our member companies are strongly concerned that the external and internal costs they are currently paying are not justified by a corresponding benefit that can be identified for them or their shareholders⁴. It would be irrational for anyone to argue that the implementation of SOX 404 is justified “at any cost.” Yet that is almost precisely the argument that was established when the actual costs of SOX 404 implementation turned out to be many multiples of the costs originally projected for that section of the Act. “Reasonableness” implies appropriate limits, and we would urge the SEC and the PCAOB to carefully examine the overall cost/benefit balance when examining claims of significant decreases in the cost of SOX 404 compliance.

PCAOB Action and Auditing Standard # 2

We have never argued for the repeal of SOX 404. We do believe that it is within the power of the SEC and PCAOB to resolve most, if not all, of the implementation problems through regulatory action. In particular, the PCAOB must be willing to clarify AS# 2 and provide much clearer guidance with respect to a range of vague and difficult-to-apply provisions. In particular, the PCAOB should:

- Provide clearer definitions for terms such as “material,” “significant,” “relevant,” and “sufficient.”

⁴ The Financial Executives International survey noted in the footnote above found that 85% of companies still do not believe that the benefits of compliance with Section 404 have exceeded the costs.

- Provide much clearer guidance on audit plans for IT systems, including guidance on the relevant importance of access controls.
- Emphasize a risk-based testing regimes and a focus on the periodic review and testing of significant entity-level controls, as opposed to individual transaction-based controls.
- Better describe the goals and limitations of the audit process. An audit is not a guarantee, and it should be made very clear to the auditing profession and to others that “reasonable assurance” is not equivalent to absolute assurance. More particularly, no audit constitutes absolute assurance against fraud, and the limitations on the responsibility of auditors to detect fraud should be clearly described.
- Ensure that the PCAOB inspections process is conducted in a way that respects the use of professional judgment and is consistent with all of the guidance provided to auditors regarding AS# 2.

In the absence of clearer guidance, the PCAOB leaves open the possibility of continual second guessing of auditors and issuers by the PCAOB and the SEC— as well as the plaintiffs’ trial bar. This is unfair to all parties. We believe that the PCAOB has an affirmative obligation as a regulator to provide all parties with sufficient guidance to allow for clear and confident determinations as to when the relevant standards have or have not been met.

Issuer Internal Control Standard

The PCAOB’s legal mandate is to be a regulator for the auditing profession. However, while AS# 2 is ostensibly a standard for auditors, there is no corresponding standard for issuers. Issuers have no ability to respond when auditors state that “this is the standard” and, effectively, the PCAOB has become a regulator to every public company that offers securities in the United States. This is not what was intended when the PCAOB was formed and it is unacceptable.

The SEC needs to promulgate an issuer standard on internal controls. While there will be issues with “competing” standards in this area, this is precisely what is needed to reach some accommodation between differing regulatory mandates. Some standard-setter in this process should accept an official obligation to maintain the overall health and competitiveness of our markets, taking into account the interests of all involved parties. All of the costs of compliance are borne by issuers, and they cannot be left without an official voice in the standards process.

Restatements

The Chamber has been very supportive of many provisions of the Sarbanes-Oxley Act outside of Section 404. We believe that it has helped to energize boards and audit committees and clarify the role of external auditors. In general, many companies now have much more thorough processes for the preparation and review of financial statements.

How is it then that the number of restatements keeps rising? It defies logic to argue that highly qualified professionals are putting in more time, energy and effort and the result is more inaccurate financial statements. An alternative— and more likely— explanation is that the effective standard for restatement has become too low.

We would strongly suggest that the SEC review the phenomenon of increasing restatements, and propose a reasoned standard that balances appropriate investor interest against the cost and confusion of restatements caused by relatively minor disagreements over accounting treatment. This should also be an opportunity to create convergence between the PCAOB and the SEC around the ultimate meaning of “materiality” in financial statements, including the relative importance of professional judgment as compared to strict quantitative tests. We believe such an undertaking would additionally be consistent with recent statements by Chairman Cox about the need to reduce complexity in accounting standards.

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In summary, it cannot be in the interest of either companies or investors for SOX 404 to be implemented in such a way that costs significantly exceed benefits. We should be able to do better. We strongly urge the SEC and PCAOB to seize the opportunity presented by the upcoming Roundtable and thoroughly explore ways in which the implementation of SOX 404 can be improved to everyone's benefit.

Thank you for your consideration.

Sincerely,

David C. Chavern
Vice President
Capital Markets Programs