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

April 1, 2005

RE: File Number 4-497

Dear Mr. Katz,

We appreciate the opportunity to provide our perspectives on *Management Assessment of Internal Controls*, Section 404 ("Section 404") of the Public Company Accounting Reform and Investor Protection Act of 2002 (the "Act" or the "Sarbanes-Oxley Act") based upon our experiences in this initial year of implementation. The Act has established clear accountabilities for those stakeholders who play a role in producing reliable financial reports and minimizing the risk of fraud. We have noted a positive change in behavior and attitude of all those involved in the corporate reporting process. We believe that Section 404 and the related implementing regulations are fundamentally sound and significant changes are not required. Accordingly, this submission outlines the reasons for our support of the Act, including Section 404, as well as certain recommendations relating to the Public Company Accounting Oversight Board's (PCAOB) Auditing Standard No. 2 (the "Standard" or "AS No. 2").

We have organized our comments into the following key sections. Where applicable, we address areas where we believe efficiencies can be gained and modifications made, regarding certain applications of Section 404, without undermining the core purpose of Section 404:

- Positive Impacts of Section 404 on the Corporate Reporting Process
- Benefits of Section 404 to Capital Market Participants
- Costs of Section 404 for Capital Market Participants
- Perspectives on AS No. 2
- Other Observations

Positive Impacts of Section 404 on the Corporate Reporting Process

Section 404 has resulted in profound changes in behavior among those who comprise key stakeholder groups in the capital market network and the corporate reporting process, including: management teams, audit committees, boards of directors, investors, regulators, attorneys, analysts, and auditors. We believe this changed behavior and heightened focus on the production of reliable financial reporting, predicated on effective internal control, is very positive. Most notably, the impacts can be summarized as follows:

- Registrants' attention to maintaining effective systems of internal control and identifying and remediating internal control deficiencies before material misstatements occur has intensified. We expect this attention will improve the reliability of financial reporting on an interim and annual basis. Section 404 has provided the catalyst to reduce the backlog of deferred maintenance on existing systems of internal control. It has also expanded internal control ownership from one primarily vested with the finance and accounting functions to one of broader ownership, including executive, business unit, and operating management.

- Audit committees and boards of directors are more attentive to their fiduciary responsibilities related to financial reporting. They have become substantially more engaged in overseeing the financial reporting processes and internal control environments of the companies they represent.

- Investors and analysts are currently being provided greater transparency into the quality of registrants' financial reporting processes, thus allowing them to make more informed investment decisions.

- Regulators have increased their complement of resources to help meet the objective of restoring confidence in the capital markets. In addition, the auditing profession is subject to a new regulatory process that provides external oversight and intense focus on the profession's business platforms, independence, and professional practices.

- Audit firms have enhanced their relationships with audit committees, extensively trained their people on auditing internal controls, and enhanced their audit approach to focus on the evaluation of internal controls along with the performance of the financial statement audit. These changes and enhancements coupled with external regulation should help to restore confidence in the capital markets.

Companies have been required for years to maintain effective internal controls under the Foreign Corrupt Practices Act of 1977; however, it was not until the Sarbanes-Oxley Act that we witnessed the behavioral changes described above. Given the widespread impact and magnitude of Section 404, we believe it will take several years for the capital markets to reap the full benefits. For example, it will take time for registrants to embed Section 404 processes throughout their organizations and benefit from the related efficiencies. Audit approaches for the integrated audit will also be refined. Finally, investors and analysts need time to understand and incorporate the new reporting model into their decision-making frameworks.

For all of these reasons, we believe that Section 404 is fundamentally sound and significant changes to Section 404 are not required. The Act should be given time to "work" as intended and provide the longer-term benefits that we believe can be derived from the legislation. All of the participants in the corporate reporting process must continue to collaborate to gain the benefits.

Benefits of Section 404 to Capital Market Participants

The marketplace continues to debate whether the benefits have been worth the costs. We believe that this question should be addressed in a comprehensive manner taking into account all of the benefits and "normalized" costs representative of future expectations. We also believe that a balanced assessment is not possible until more data about on-going costs and benefits are gained over a period of time that allows for greater realization of the benefits. The efforts and resource requirements in the first year of applying Section 404 ("year one") were extraordinary. Although company-specific savings will vary, we expect the overall marketplace to benefit from meaningful reductions in internal and external costs in the upcoming years.

Moreover, while we have seen benefits from Section 404 at our clients, we would expect these benefits to increase in future years. Most notably, effective internal control provides companies with the opportunity to identify and remediate control deficiencies before material misstatements occur in their financial statements. We have observed that hundreds (sometimes thousands) of deficiencies have been identified and remediated at individual companies. In an analysis of 225 registrants, we noted that they identified and remediated nearly 63,000 control deficiencies in the aggregate or approximately 275 control deficiencies per company. In addition, we estimate that over 40% of these companies remediated or newly implemented over 25% of their key controls in year one. These efforts benefited investors and preparers by enabling companies to avoid possible costly material misstatements, improving the reliability of the financial information provided to the marketplace, reducing the likelihood of material frauds, and potentially improving business processes.

Below, we have listed more specific benefits stemming from Section 404. We have grouped these benefits into three categories: 1) Benefits to Investors, 2) Enhanced Business Processes, and 3) Reduction of Risk.

Benefits to Investors

- *Reliability and transparency of financial statements*. The investor community has and will continue to benefit from increased reliability and transparency of the financial information that management provides. One of the fundamental objectives of Section 404 is to enhance investor confidence in the financial information produced and used for their decision-making. The year one reporting sets a foundation for investors to monitor a company's progress and changes in internal control. In order for investors to gain more confidence, time must pass showing that Section 404 does reduce the risk of corporate fraud and potentially improves the stability of the capital markets.

- *Efficient allocation of capital.* A vibrant and stable capital market depends on, among other things, reliable, transparent, and objective financial information in addition to stable governance that minimizes country and political risk to achieve an efficient allocation of capital. These are characteristics enjoyed by the US capital markets. The Act promotes the efficient allocation of capital in part by improving the reliability of the financial information produced for use in the US capital markets. When investors make future estimates of a company's earning power, they inherently must consider the reliability of the information upon which their estimates are based. Improving reliability enhances investor confidence and should result in a more efficient allocation of capital among market participants.

Enhanced Business Processes

- *Simplification and standardization.* During the initial year of adoption, companies identified redundant controls and were often required to evaluate and test controls at numerous locations and on multiple operating systems due to the nature of decentralized and non-standardized processes. This evaluation process has brought visibility to the importance of simplification, standardization, and centralization of processes and controls. Companies will continue to evaluate opportunities to standardize their processes and evaluate whether greater use of "shared service centers" or other more centralized processes are appropriate.

- *Enhanced appreciation and accountability for internal controls.* Management and employees have a greater appreciation and understanding of what controls are and why they are important and are incorporating them into their day-to-day responsibilities. This increased awareness promotes the identification and potential elimination of redundant controls and control deficiencies that may not have been identified or understood in the past.

- S*hift from manual controls to automated controls.* Throughout the evaluation process, many companies have learned that most of their key controls are manual despite significant investments in information technology. This observation will likely result in increased leveraging of technology in the upcoming years, which should drive significant efficiencies.

Reduction of Risk

- *An enhanced control environment and "tone at the top."* The new external reporting requirements, risk of penalties, and publicity of corporate failures have resulted in significant focus on internal control at the most senior levels of an organization. This focus includes greater emphasis on ethics and anti-fraud policies, increased communication of expectations, improved quality, discipline, and teamwork, greater accountability, and enhanced culture.

- *Improved merger and acquisition due diligence.* As a result of the Act, we have seen companies enhance their due diligence functions involving acquisition candidates. These enhancements have included comprehensive internal control reviews and mandated remediation efforts prior to the closing of the transaction. This increased focus on internal controls may result in improved post acquisition performance and the enhanced likelihood of identifying and correcting concerns prior to acquisition.

- *Availability of funding and resources to remediate internal control deficiencies.* In the past, many companies underinvested in their accounting functions and internal control environments. Given the new requirements, we have observed companies allocating greater resources to improve internal controls and remediate deficiencies.

Costs of Section 404 for Capital Market Participants

While we have identified many benefits of Section 404, we also understand concerns expressed about the significance of costs associated with Section 404. The costs are tangible, quantifiable, and immediate, while many of the benefits are intangible, harder to quantify, and longer term. However, we believe that the learning curve and resource requirements in the initial year of adoption represent a non-recurring investment that will be leveraged in the future. Future compliance costs are likely to be much lower than in year one. Thus, we believe that the costs of first year implementation will not be indicative of on-going costs of compliance. For example:

- Few, if any, companies had documentation sufficient to meet the requirements of Section 404. We estimate that companies spent on average approximately 25% of their total Section 404 resource time on documentation. Thus, in year one, significant efforts were required to document key controls and processes. In the future, this required documentation will only have to be updated.

- Numerous control deficiencies were remediated in year one. As indicated previously, in an analysis of 225 registrants, companies remediated on average 275 control deficiencies in year one. We estimate that companies spent on average approximately 15% of total Section 404 resource time remediating deficiencies. The significance of time expended to remediate deficiencies in year one indicates the magnitude of the deferred maintenance that has historically existed. We do not expect this degree of remediation will be required in future years.

- Companies invested significant time and resources to train employees on the new requirements, particularly in light of the fact that management teams and employees lacked thorough implementation guidance. Based on the experience gained in year one, however, company resources should be more familiar with and knowledgeable about the requirements of Section 404 going forward.

- Companies also invested significant time in year one developing their overall Section 404 approach and testing plans and evaluating the design effectiveness of internal control over financial reporting, and unremediated deficiencies. In an analysis of 225 registrants, on average companies evaluated approximately 85 unremediated deficiencies at year-end. We believe management will be able to leverage its initial year planning efforts and reduce the time spent in all of these areas in future years.

The costs noted above are primarily attributable to a company's internal environment. In addition to the substantial internal costs, there have been a number of external factors that contributed to year one costs being significant. We expect that most of the costs associated with the external factors described below would not recur in subsequent years. Three of the more significant external elements contributing to the higher cost were:

- *Implementation guidance for registrants.* Little implementation guidance was available to registrants on how to evaluate internal controls and apply Section 404. Without appropriate guidelines directed to registrants, AS No. 2 (intended for the auditor) operated in year one as the de facto operating principles for most companies. We believe a project should be undertaken to provide registrants with application guidance for evaluating internal controls and for complying with the provisions of the Act.

- *Learning curve and efficiencies associated with Section 404 and AS No. 2.* The requirements of Section 404 and AS No. 2 are complex and far-reaching. During year one, management and external auditors were learning, interpreting, and applying Section 404 and AS No. 2 on a real-time basis. The second and subsequent times through any new undertaking of this magnitude generally yield efficiencies, and thus reduced costs. We expect that to be the case in applying the provisions of Section 404 and AS No. 2, as well. Also, the knowledge and audit evidence gained from auditing the internal control over financial reporting will be leveraged in the conduct of the integrated audit reducing some of the procedures historically performed in the financial statement audit. This benefit will vary from company to company based on the nature of the company's operations and the level of historical reliance on internal controls in the audit of the financial statements.

- *The impact of a regulatory environment.* We acknowledge that some portion of the costs may be attributed to the new regulatory environment for the auditing profession. Companies and auditors understand that the decisions they make in evaluating a deficiency or determining the scope of procedures may be challenged at a later date – which inherently results in increased time and effort to make such evaluations and determinations. Greater use and acceptance of professional judgment allows auditors to gain efficiencies in the integrated audit and to leverage their historic knowledge of a registrant. We believe that it is important that all stakeholders in the corporate reporting process recognize the need for significant professional judgment and be balanced in how they evaluate well thought-out and documented judgments. Although said in the context of "principles based standards," Robert Herz, Chairman of the Financial Accounting Standards Board (FASB), acknowledged these concerns in his remarks at the December 2004 AICPA National Conference on Current SEC and PCAOB Developments. He indicated that "there also seems to be a real fear of being second-guessed by regulators, enforcers, the trial bar, and the business press and that has, at least for now, very understandably seemed to reinforce the demand for detailed rules, bright-lines, and safe-harbors."

Perspectives on AS No. 2

While AS No. 2 prescribes how auditors are to conduct the audit of internal control, its interaction with Section 404 has implications that management needs to consider when determining the scope of the work required to execute its Section 404 responsibilities. As a result, when evaluating the effectiveness of Section 404, it is important to consider the following fundamental underpinnings of AS No. 2, which include:

Materiality - The same conceptual definition of materiality that applies to financial reporting also applies to evaluating internal control over financial reporting, including the relevance of both quantitative and qualitative considerations.

Auditor opinion on internal control over financial reporting - We support the Standard's requirement that the auditor opine on management's assessment and directly on the effectiveness of internal control over financial reporting. We believe that restricting the audit to evaluating management's evaluation process would not provide the auditor with an independent level of assurance that management's conclusion is appropriate. The auditor needs to evaluate management's assessment process and independently test the effectiveness of internal control to be satisfied that management's conclusion is appropriate and, therefore, fairly stated.

Reasonable assurance - The audit of internal control over financial reporting is designed to obtain reasonable assurance on whether internal control over financial reporting is effective. Although not absolute assurance, reasonable assurance is, nevertheless, a high level of assurance that drives the nature and extent of testing. We believe that the concept of reasonable assurance is appropriate to provide financial statement users with the confidence that internal control over financial reporting is effective at a company.

Principal level of evidence - The Standard requires the auditor to perform sufficient control testing so that the auditor's own work provides the principal evidence for its opinion. This requirement is of paramount importance to providing the level of reliability that investors expect.

We believe these fundamental underpinnings should not be changed. They are integral to the audit of internal control over financial reporting and are entirely consistent with the objectives of the Sarbanes-Oxley Act. We also believe they are important to maintain a rigorous process to avoid Section 404 becoming a mere compliance exercise.

We do however; have the following observations and suggestions with respect to AS No. 2 that may have a positive impact on the cost/benefit equation. In all cases, clarifications and changes to AS No. 2, including those listed below, should be approached with caution to ensure that they will not negatively affect the quality of the integrated audit.

- *Risk-Based Approach.* AS No. 2 requires the auditor to obtain evidence each year about the effectiveness of controls for all relevant assertions related to all significant accounts and disclosures in the financial statements. The Standard allows the auditor to vary the nature, timing, and extent of testing from year to year. We believe decisions on how to vary the nature, timing, and extent of testing should be based upon the auditor's judgment of relative risk and the extent of review and testing performed at the location by other parties. Our experience in year one would indicate that differing views have emerged among certain stakeholder groups on how to apply this judgment. We believe the PCAOB should provide clarification in this area.

- *Self-Assessment.* The Standard currently does not allow the auditor to rely on management's self-assessments. We believe self-assessments will be used extensively by management in future years to embed the evaluation of internal control over financial reporting in the recurring financial reporting process. Self-assessments are accomplished in many different forms and iterations. In certain circumstances, except for self-assessments that are made by the same personnel who are responsible for performing the control, we believe the auditor should be allowed to make use of these self-assessments.

- *Interim Materiality.* AS No. 2 requires evaluation of deficiencies for their potential effect on interim financial statements, which effectively lowers the materiality threshold to the quarterly measure. We believe known misstatements, resulting from a control deficiency, should continue to be evaluated against quarterly materiality. However, when a deficiency does not result in a known misstatement, we believe the estimated annual misstatement should be evaluated against annual materiality measures.

- *Rollforward Requirements.* The Standard requires that the auditor and management report on the effectiveness of internal control over financial reporting as of a point in time. If testing is performed substantially prior to year-end, management and the auditor will be required to update their testing. This requirement creates a significant burden late in the fiscal year. We recommend that the PCAOB consider allowing for a risk assessment in which auditors would be allowed to perform testing of controls within lower-risk processes earlier in the fiscal year without the significant burden of year-end updating where such processes have not changed after the initial testing.

- *Automated Application Controls.* There are varying views as to how much evidence should be obtained each year about the effectiveness of each automated application control when information technology general controls (e.g., program change controls) are operating effectively. If the auditor determines through annual walkthroughs that automated application controls have not changed and determines annually that information technology general controls are designed and operating effectively, we believe it should not be necessary to test automated application controls every year.

Other Observations

In addition to the capital market observations, the benefits and costs associated with the Act, and our perspectives on AS No. 2, we also make the following additional observations for your consideration:

- *Auditor Advice.* There has been significant concern among registrants and their auditors as to the extent external auditors can provide accounting and financial reporting advice to their clients. We believe this concern was an unintended consequence of the Act and substantially limited the necessary and important dialogue between a company and its external auditors in some instances. Active dialogue between the auditor and management on the application of complex standards is paramount to improving both financial statement and audit quality. We recognize that the SEC and PCAOB addressed this matter through various public speeches and the PCAOB's questions and answers; however, it is our experience that this unintended consequence continues. We recommend the SEC and PCAOB continue to publicly support this important dialogue between management and the auditor.

- *Improvements to the COSO Framework.* In the United States, the COSO framework is the most widely accepted framework for evaluating a Company's internal controls. The SEC, PCAOB, and other regulatory bodies recognize the COSO framework as meeting the evaluation criteria outlined in the Act. This acknowledgement does not preclude companies from utilizing another acceptable framework, but few if any companies have or will avail themselves of another alternative in the near term.

  We agree that the COSO framework presents a solid foundation and is appropriate in many circumstances. However, the COSO framework, developed in 1992, has not been revisited in nearly 13 years. The complexity of business and internal controls has evolved over this same time period. We believe a comprehensive review of the COSO framework should be considered. Additionally, practical implementation guidance would be useful to assist smaller businesses and less complex entities in applying the COSO framework.

- *Supplementary Information.* Currently, the SEC's Frequently Asked Question No. 23 (FAQ) excludes supplementary information from management's assessment of internal control over financial reporting. The FAQ indicates the SEC staff is considering the issue of including supplementary information in management's assessment. Before requiring such information to be included in the assessment, the SEC staff should consider carefully the increased efforts required by management and the external auditor to do that (particularly with respect to activities associated with oil and gas producing properties). Elevating the controls associated with developing supplementary information to the assessment process under Section 404 could increase management and auditor efforts significantly.

Conclusion

In conclusion, we repeat our observation that since the Act became effective, we have noted a profound change in the behaviors and actions of all key stakeholders who participate in the production of financial information designed for consumption by the capital markets. We believe that each key stakeholder group that is responsible for the production of reliable financial information has gained a deeper appreciation for that responsibility. And we believe this forms a solid foundation to support reliable and objective information that investors in the US capital markets expect and deserve.

We also acknowledge that, as should be expected from the reforms called for by Section 404, it will take time for the capital market system to adjust to and realize the full scope of the benefits that will result. And we also acknowledge that it is appropriate to consider the refinements that could be built into the system after the first year of implementation. We have offered our thoughts and observations in the preceding pages.

In final summary we offer three thoughts:

- First, we believe that the Act helps to lower the inherent risk in the US capital markets and enhance investor confidence, thus resulting in a more efficient allocation of capital among market participants.

- While the costs of complying with the new internal control reporting model established by the Act and AS No. 2 are significant, we continue to believe that the core of the Act and the fundamental underpinnings of AS No. 2 should be allowed the time needed to prove that the ultimate benefits to investors can be realized.

- And lastly, we believe that the broader ownership of internal control over financial reporting by executive, business unit, and operating management is a significant benefit to investors. Couple that with potential clarifications and revisions to AS No. 2 and we believe the cost/benefit equation becomes more balanced.

We hope these recommendations prove useful as you consider the first year results of Section 404. Please contact Raymond J. Bromark at (973) 236-7781 if you have any questions.

Very truly yours,

PricewaterhouseCoopers LLP