

September 12, 2006

F.A.O. Nancy M. Morris  
Secretary  
Securities and Exchange Commission  
100 F Street, NE.  
Washington, D.C. 20549-1090  
USA

By E-Mail: [rule-comments@sec.gov](mailto:rule-comments@sec.gov)

Dear Ms. Morris:

**Re.: File No. S7-06-03**

**SEC Release No. 34-54294A Concerning Internal Control Over Financial Reporting in Exchange Act Periodic Reports of Foreign Private Issuers that are Accelerated Filers – Final Rule; extension of compliance dates**

**SEC Release No. 34-54295 Concerning Internal Control Over Financial Reporting in Exchange Act Periodic reports of Non-Accelerated Filers and Newly Public Companies – Proposed extension of compliance dates**

The Institut der Wirtschaftsprüfer in Deutschland [IDW: Institute of Public Auditors in Germany] is pleased to have the opportunity to comment on the above-mentioned releases concerning the Securities and Exchange Commission's intention and proposal to extend certain compliance dates relating to compliance with the internal control requirements mandated by Section 404 of the Sarbanes-Oxley Act of 2002. The IDW represents the profession of public auditors in Germany and is seeking to comment on the final rule and the proposal, as those IDW members that audit, or are involved in the audit, of foreign private issuers or German subsidiaries of other issuers may be affected by the rule and the proposals, if adopted.

In this letter, we explain our significant concerns, and address certain questions raised in Release No. 34-54295 (primarily with regards to non-accelerated filers) in the attached appendix. We do not seek to comment on proposals affecting newly public companies. Overall, however, we would like to emphasize that we fully support the Commission's objectives to improve financial reporting, corporate governance and audit quality.

*Consistency of the reporting deadlines for management and the auditor*

We would firstly like to state that we support the initiative taken by the SEC to extend certain compliance deadlines for foreign private issuers that are accelerated filers (but not large accelerated filers) and for non-accelerated filers, pending the issuance of further guidance. However, we firmly believe the deadlines for management reporting of its assessment and auditor reporting pursuant to Section 404 (a) and (b) should remain synchronized. Consequently, we strongly urge the SEC to extend the compliance deadlines for management's assessment and reporting thereof accordingly.

In our opinion, a requirement for management to respectively file or furnish a report on the effectiveness of the company's internal control over financial reporting without an accompanying auditor's attestation report will not lead to adequate management assessments of internal control and have an undesirable impact on the audit in subsequent periods. We believe that management is unlikely to determine and report material weaknesses in internal control by means of the management assessment of internal control for an internal control system for which management is responsible. In other words, management would not apply the same discipline to its assessment as in those circumstances when the management assertion based upon the assessment were subject to an independent audit and hence closer dialogue with the auditor about the management assessment process. This is not principally because we believe management is dishonest, but that management's assessment is subject to the so-called "self-review threat" and would not benefit from the closer dialogue with the auditor about the management assessment. When material weaknesses are subsequently identified as such by the auditor in the following year, management may find itself in difficulty to justify the position it had taken in the past, even when the new management assessment is accompanied by the auditor's report.

Furthermore, in the subsequent period when the internal control system is subject to audit, there is a greater risk that the auditor and management will be in conflict over material weaknesses in internal control in that management had not regarded as such in the previous period not subject to audit.

Although this applies equally to foreign private issuers that are accelerated filers and to non-accelerated filers, we note that this issue is not discussed in Release No. 34-54294A in respect of foreign private issuers that are accelerated filers. In contrast, on pages 13 and 14 of Release No. 34-54295 in respect of non-accelerated filers the SEC raises the related issue that a company “may become subject to more second-guessing ... than under the current requirements”. In our view, the SEC has raised only one possible consequence. Undeniably, this specific impact on capital market users (second guessing, i.e., a reduction in quality of information made available to investors) is undesirable, however, we believe this is not the only consequence requiring consideration.

In addition, differentiation of reporting deadlines will have a direct detrimental impact on the relationship between an issuer’s management and the auditor. We note that page 13 of Release No. 34-54295 refers to the fact that the SEC encourages “frequent and frank dialogue among management, auditors and audit committees to improve internal controls and the financial reports upon which investors rely”. This reiterates a concept discussed in the Commission Statement on Implementation of Internal Control Requirements dated May 16, 2005. We have serious concerns that this rule and proposal may be extremely detrimental by straining, or in the extreme case, by constricting, the relationship.

It is clear from the releases that the SEC anticipates a significant reduction in audit work and thus in costs from the forthcoming and proposed extensions.

We do not agree with the contention set forth in the release, that a more gradual transition to full compliance will ultimately make implementation of the internal control over financial reporting requirements more effective. Whilst this may well hold true in the temporarily from a cost point of view in some cases, we do not agree that this will always be the case in the long run. Certainly there may be qualitative issues associated with implementation, in addition to those referred to above, that will have an adverse impact on effectiveness.

For example, even though the forthcoming and proposed extensions will mean that the auditor would not be required to prepare an attestation report on management’s assessment of internal controls over financial reporting, the auditor may, as part of the audit of the financial statements, nevertheless be obligated to undertake additional work in this respect. Pursuant to AU §550.06 and AU §9550.11, if the annual report contains, what, on the basis of knowledge gained in the audit of the financial statements, is, in the auditor’s professional opinion, a material misstatement of fact in relation to management’s report on its assessment of internal control, the auditor is obligated to perform more work and consider the impact on the audit report. Therefore, combined with other factors, such as a lack of constructive auditor involvement

in the initial stages noted above, anticipated short term cost reduction is likely to be less than anticipated in some cases.

We hope you find our comments helpful and would be pleased to be of assistance to you if you have any questions about these comments.

Yours very truly,



Klaus-Peter Feld  
Executive Director



Wolfgang P. Böhm  
Director, International Affairs

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Appendix

## APPENDIX

*Is it appropriate to provide a further extension of the compliance dates of the internal control over financial reporting requirements for non-accelerated filers? If so, are the proposed extensions for compliance with management and auditor attestation report requirements appropriate in length or should they be shorter or longer than proposed? Should the Commission consider a further extension if the revisions to Auditing Standard No. 2 and the release of guidance for management are not completed in sufficient time to permit issuers and auditors to rely on them?*

We agree it is appropriate to extend deadlines pending issuance of further guidance for management and amendment of AS-2.

We do not agree that deadlines for management and auditor reporting should differ, and accordingly urge the SEC to likewise extend compliance deadlines for management reporting. We refer to our letter, in which we set forth our concerns.

Furthermore, as the SEC is currently discussing possible guidance for issuers in relation to Section 404, and the PCAOB amendments to AS-2, we believe that a corresponding postponement, at least until such guidance becomes available, of the requirement for filing of management's report would be additionally helpful in alleviating the burden facing management. Corresponding postponement would allow management to assess and modify the entity's controls on a "trial run" basis, affording management the opportunity to discuss issues with the entity's external auditors and rectify any problems before either come under pressure to report. Therefore, we believe an alignment of the reporting deadlines will be more likely to lead efficient initial compliance by both management and the external auditor.

*Is it appropriate to implement sequentially the requirements of Section 404(a) and (b) of the Sarbanes-Oxley Act, as proposed, so that a non-accelerated filer would only have to include management's internal control assessment in the annual report that it files for its first fiscal year ending on or after December 15, 2007 and would not have to begin providing an accompanying auditor's attestation report until it files an annual report for a fiscal year ending on or after December 15, 2008?*

No, as discussed in our accompanying letter, we do not agree that there should be a difference in compliance deadlines. Accordingly we urge the SEC to extend the compliance deadlines for management reporting also.

*Would the phasing-in of the management assessment requirement and auditor attestation report requirement make the ultimate application of Auditing Standard No. 2 more or less efficient and effective?*

Considerably less effective, for the reasons we have explained in our letter. The contention made in the release that this will benefit investors and improve confidence in the reliability of the disclosure made by these companies about their internal control over financial reporting appears to us to be one-sided. We would like to point out that the SEC's consideration of cost-benefit centers entirely on cost reduction by merely acknowledging potential risks that could stem from a lack of required auditor involvement without considering these in any detail. The release discussion of costs refers to discussions at the roundtable held on May 10, 2006 on costs but does not refer in any way to the views then stated as to the benefit of an auditor's attestation report on management's assertion. In our view, the comments made by Mr. Jonas of Moody's Investors during panel 4 "Effect on the market" on page 178 and 180 of 245 transcript of the roundtable discussion of May 10, 2006, and Mr. Bowsher, former Comptroller General of the United States, on page 179 and 181 must also be taken into account in deliberating this issue.

*Is it appropriate to deem the management report on internal control over financial reporting to be "furnished" rather than "filed" during the first year of a non-accelerated filer's compliance with the Section 404 requirements? If so, is it also appropriate to take the same action during the first year of compliance with the Section 404 requirements by a foreign private issuer that is an accelerated filer, but not a large accelerated filer, and that files its annual reports on Form 20-F or 40-F?*

We disagree that the management report on internal control over financial reporting should be made publicly available without an accompanying auditor's attestation report. Accordingly we urge the SEC to extend the compliance deadlines for management reporting also. Furthermore, if the auditor's report is "filed", then so should the management report.

*Would management's assessment of internal control over financial reporting provide meaningful disclosure to investors, independent of the auditor attestation report? Is there an increased risk that management will fail to identify a material weakness in the company's internal control over financial reporting, and if so, do the potential benefits of the proposal outweigh this risk?*

We do not believe management's assessment of internal control over financial reporting would provide meaningful disclosure to investors, independent of the auditor attestation report. There is a very real risk that management will fail to identify a material weakness in the company's internal control over financial reporting, when the auditor is not involved in the process. As set forth in our letter, we have serious concerns. The perceived benefits are unlikely to outweigh this risk in the long term.

*Are the proposed extensions in the best interests of investors?*

We do not believe they are, as they may ultimately erode investor confidence in the audit function foreseen by the Sarbanes-Oxley Act of 2002.

*Should we require a non-accelerated filer to disclose in its annual report that management's assessment has not been attested to by the auditor during the year that the audit attestation report is not required?*

This measure has to be viewed as an absolute minimum. As explained in our letter we urge the SEC to align the reporting deadlines by correspondingly extending deadlines for management reporting.

*Simultaneously with the publication of this release, we are issuing a separate release to extend the date by which a foreign private issuer that is an accelerated filer (but not a large accelerated filer), and that files its annual reports on Form 20-F or 40-F, must begin to comply with the auditor attestation report portion of the Section 404 requirements. Is there any additional relief or guidance that we should consider specifically with respect to foreign private issuers?*

We find it rather discouraging that the SEC considers notice and solicitation of comment regarding the extension of the audit attestation report compliance date for foreign private issuers that are accelerated filers (but not large accelerated filers) "impractical, unnecessary and contrary to the public interest". In our opinion, the reasoning provided in the release document is less than persuasive. The potential consequences warrant further deliberation and we therefore urge the SEC to reconsider this issue, and, as noted above, to deliberate the merits of extending the deadline for filing of management's report such that filing of both management's and the auditor's reports on internal control over financial reporting are subject to the same deadlines.