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May 1, 2006

Nancy M. Morris
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Re: Roundtable on Second-Year Experiences with Implementation of Sarbanes-Oxley Internal Control Reporting and Auditing Provisions (File Number 4-511)

Dear Ms. Morris:

It is an honor to be invited to participate in the Commission's Roundtable on May 10, 2006. Given the topic of my panel, I will limit my remarks to my view of the future of Section 404.[1]

While I believe that Section 404 is necessary for investor protection and the public interest, I also believe that changes should be made to make Section 404 workable. The situation concerning Section 404 should be contrasted to the three-year process which resulted in the final adoption in August 1983 of Rule 415, the shelf rule. As a staff member, I was involved in the rule being published for comment three times, participating as a hearing officer in the public hearings, as well as in the Commission's adoption of a temporary rule on an experimental basis and in its adoption as a permanent rule. Rule 415, one of the Commission's most successful rules, was thus given multiple opportunities to work before being finally adopted.[2] The explicit statutory time periods under Sarbanes-Oxley did not permit the Commission to follow the trial-and-error path that the Commission followed in adopting the shelf rule. However, I would suggest that the two-year period since Section 404 became effective for

[1] For my other views on the Sarbanes-Oxley Act of 2002 ("SOX"), please see my outline co-authored with Julie K. Hoffman, "Sarbanes-Oxley Act of 2002 and SEC Rulemaking" which is printed in the ABA's The Practitioner's Guide to the Sarbanes-Oxley Act, Vol. 1, I-1, (2004) and my article co-authored with Joel H. Trotter, "Disclosure of Internal Control Over Financial Reporting", which is printed in Vol. III (2006), the editors of which are Stanley Keller, Vasiliki Tsaganos, Jonathan Wolfman and me.

[2] Even after being adopted on a permanent basis, the rule has been fine-tuned to keep up with the changing market conditions, most recently as part of the Securities Offering Reform proposals which became effective on December 1, 2005 (Release Nos. 33-8591; 34-5206, July 19, 2005).

accelerated filers provides a database of experience to assess, review and revise the rules under Section 404 to make it more successful in the future.

Thus, I believe the time is ripe to revise the rules under Section 404 as well as Audit Standard No. 2, not to eliminate, but to improve, not to exempt, but to accommodate the needs of all registrants, not to give up, but to achieve its original purpose of enhancing investor confidence.[3] This effort would have four objectives:

- To achieve a better balance between the regulation, on the one hand, and the needs of the marketplace and the costs incurred by registrants, on the other. Not all registrants are in the same position to comply with Section 404. One size of Section 404 regulation does not fit all companies. When non-accelerated filers become subject to Section 404, they should not have to comply with the same requirements imposed on accelerated filers.

- Amend the rules to link the disclosure to the needs of the marketplace and investors, such as having the definition of a material weakness be something that when disclosure of it is made, the stock price is affected.[4] If that occurs, internal control over financial reporting will serve its purpose of acting as the "canary in the mineshaft" of the financial statements.

- Attempt to change the mindset of all the constituencies that affect the Section 404 process – registrants many of whom have only focused on costs and not benefits; auditors who are too concerned about being criticized by a PCAOB inspector; and regulators who are reluctant to defer to the judgment of registrants and their auditors.

- Consider foreign private issuers as part of a global marketplace and understand that US markets should continue to be gold standard of capital formation.

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[3] I urged the Commission and the Public Company Accounting Oversight Board (the "PCAOB") to revise the definition of material weakness in my written and oral remarks at the Roundtable in April 2005. Others have now joined me in the same conclusion since the May 2005 guidance was issued by the SEC and PCAOB. See, e.g., Harvey L. Pitt, "Make Sox Fit," Wall Street Journal, at A 12 (April 13, 2006); Alan L. Beller, Remarks at the Committee on Federal Securities Regulation of the Business Law Section of the American Bar Association in Tampa, Florida (April 8, 2006); and Robert C. Pozen, "Why Sweat the Small Stuff, "Wall Street Journal at A 20 (April 5, 2006).

[4] Under the current definition, the marketplace's reaction to disclosure of a material weakness is typically to ignore or discount the significance of such disclosure because "everyone has one."

With these objectives in mind, my specific suggestions are:

- Develop COSO guidance that meets the needs of smaller companies, so that non-accelerated filers do not believe that the regulatory structure of the Fortune 500 is being imposed on them.

- Co-ordinate with the European Union to develop an international standard of internal control over financial reporting so that foreign private issuers come to the United States to be listed, rather than pursue alternatives to de-list from US markets.[5]

- Revise Auditing Standard No. 2, not to change its overall structure, but to amend it to reflect the experience of the past two years, as well as to anticipate the issues that non-accelerated filers will confront.[6]

- Review the definitions of disclosure controls and procedures, on the one hand, and internal control and procedures, on the other hand, so that the ordinary American investor can understand what the relationship between disclosure controls is to internal controls.

- Create a pilot project for unaccelerated filers so that the Commission and public companies have the ability to learn from experience to establish a permanent framework for smaller public companies.[7]

- Make the zone of reasonableness, discussed in the May 2005 guidance, a meaningful concept that works in practice and promotes, rather than deters, the exercise of judgment by registrants and auditors alike.

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[5] See, e.g., William H. Lash III, "Reforming Deregistration, SEC Should Make Major Fix," The Washington Times at A 23 (April 26, 2006) and Bob Greifeld, "Its Time to Pull Up our SOX," Wall Street Journal (March 6, 2006).

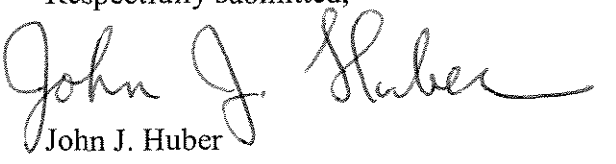
[6] For example, the structure of the term material weakness – probability and magnitude – is appropriate, but the thresholds – more than remote likelihood based on FAS 5 and materiality based on SAB 99 – are too low. The PCAOB should raise the bar to "likely" rather than the current standard of "more than remote likelihood" and the Commission should revise SAB 99 to ensure that the definition truly reflects the standard of what as reasonable investor would need to know to make an informed investment decision. Another example would be to revise Auditing Standard No. 2 so that the top down, risk based guidance from May 2005 results in focusing on what is important and decreases the amount of time, effort and cost expended by registrants, consultants and auditors. Still another example is to have less documentation than what is required by Auditing Standard No. 3 for auditors.

[7] This is the suggestion made by Deloitte & Touche LLP in its April 3, 2006 comment letter to the Commission on the Exposure Draft of Final Report of the Advisory Committee on Smaller Public Companies, Release Nos. 33-8666 and 34-53385, File No. 265-33.

- Promote a regulatory system that trusts the judgments of registrants and auditors more than is currently the case. This does not mean returning to the pre-SOX system, but it would recognize that the overwhelming majority of registrants just want to know how to comply, what they have to do to comply and do not intend to evade or defraud. Establishing a workable standard of "trust, but verify"[8] would be a major component of revising Section 404.

In conclusion, I commend the Commission and the PCAOB for conducting the Roundtable and appreciate the opportunity to participate.

Respectfully submitted,



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[8] This phrase is borrowed by me from President Reagan.