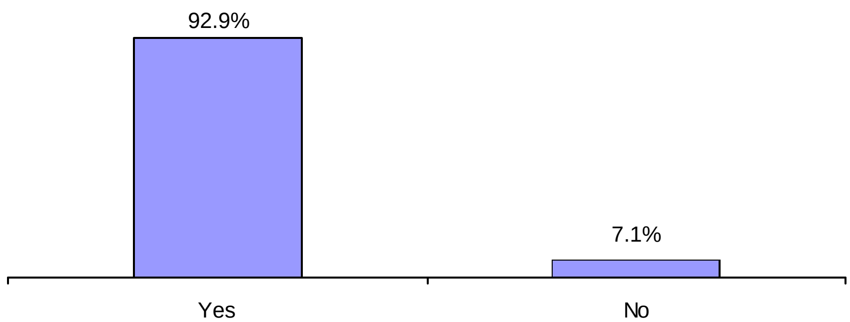
The Controllers' Leadership Roundtable provides best practices research, decision support tools, and executive education to a membership of Controllers from the world's leading corporations and not-for-profit institutions. Our mission is to increase the effectiveness of executives and their enterprises by discovering and teaching to this membership the best new thinking and strategies from across industry and around the world. The Controllers' Leadership Roundtable's parent company, the Corporate Executive Board, has a membership of more than 75% of the Fortune 500 and more than 2,200 leading organizations from around the globe.

Following the SEC's concept release relating to Management's Report on Internal Control over Financial Reporting, the Roundtable surveyed its members in order to aggregate their opinions. The information below highlights the results of that survey. This survey does not represent the views of the Roundtable or its membership as a whole; rather these are the views of the 14 respondents to our survey.

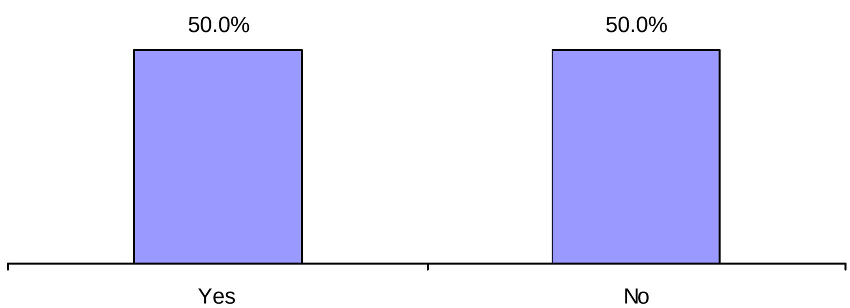
SHOULD THE SEC PROVIDE GUIDANCE?

The respondents overwhelmingly showed interest in receiving more guidance from the SEC. However, they reported numerous concerns about having to change current approaches to compliance and worries that guidance would disallow the usage of judgment.

- **Would it be useful to have additional guidance from the SEC on how to evaluate the effectiveness of a company's internal controls over financial reporting?**



- **Are you concerned that detailed guidance from the SEC could hamper future efforts by others in this area?**



- **What concerns do you have about the SEC providing guidance? What can the SEC do to mitigate these concerns?**
  - Concern: "We have everything set and are in basic agreement with our external auditors. This is the first year the process should become efficient for us, and where we will begin to enjoy internal/external cost savings. We are concerned that this new guidance will start the "negotiation" process with the external auditors all over again." Remediation: "Align the guidance with that already issued to the auditors." – Utilities Company
  - Concern: "Timeliness - i.e., if they provide new guidance in the fourth quarter it will create a big fire drill." Remediation: "Release the guidance early in the year, preferably late first quarter." – Transportation Company
  - Concern: "It can also be costly for an issuer to change its SOX compliance approach as well (including such change management components as internal strategy, documentation revision, training, external auditor review, etc)."

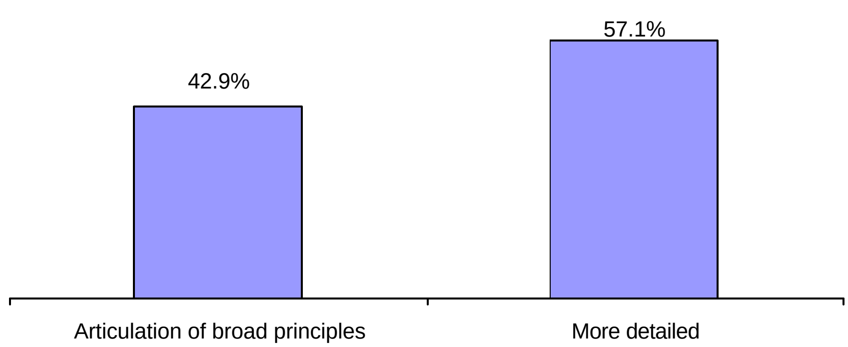
Remediation: "Guidance for management should therefore not be required for issuers to adopt, rather be considered an option for issuers to consider." – Pharmaceutical Company

- Concern: "Would become too rules based and over empower the PCAOB."
  Remediation: "Focus more on key principles and monitor the work of the PCAOB staff in their reviews of audit firms." – Telecommunications Company
- Concern: "May get too prescriptive and we would end up changing our current methodology."
  Remediation: "Keep it short and to the point with lots of examples." – Energy Company
- Concern: "Guidance will be too specific and will alter current compliance approaches approved by auditors. Preference would be for no guidance. However, if the SEC is intent on providing guidance, would prefer that it be only on the topics requested by registrants."
  Remediation: "Issue guidance that is broad, principles based and that focuses on providing clarifications to certain issues versus providing rules/strict interpretations." – Restaurant Company
- Concern: "Guidance might be too specific and difficult to apply to varying situations/facts. However, the SEC governs auditors as well as registrants; therefore, any guidance issued by the SEC could help address gaps or clarify guidance issued by others."
  Remediation: "Guidance should focus on principles, provide examples to facilitate analysis - be interpretative."– Utilities Company
- Concern: "Too narrow and "rules" focused."
  Remediation: "Adopt broad principles-based guidance." – Food Services Company
- Concern: "SEC needs to consider the practical application of any guidance they provide. Guidance issued to date (e.g. May 16, 2005) was very high level and interpreted by the Public Accounting Firms as supporting their overly conservative interpretation of AS 2 which required that management's assessment of controls should be, in most respects, just as detailed as it is for the audit firms."
  Remediation: "Guidance should clearly leave room for judgment to be made by management in applying the rules. As well, the guidance should be more detailed." – Chemicals Company
- Concern: "The quality of the SEC guidance to date has been so thoughtful that we do not have a lot of angst on this subject. The main concern is that they might enshrine key concepts which do not fit the work we have already done."
  Remediation: "They need to address guidance directly to the registrants, and consider the registrants' points of view. It would not be at all out of place to create "standards" such as AS 2 oriented to the registrants. They need to continue reliance on the conceptual environment that has been established. This should be an evolution, not a retracing." – Energy Company
- Concern: "If the guidance is too formulaic or specific then it hampers the ability for management or for the auditors to apply proper judgment in unique situations."
  Remediation: "Keep the guidelines principle-based with practical examples used to express more detailed guidance rather than proscribed methods or conclusions." – Manufacturing Company

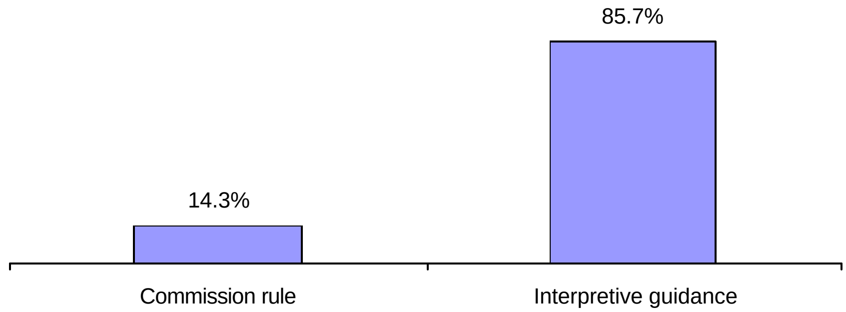
SEC GUIDANCE FORMAT

While the respondents were divided between wanting an articulation of broad principles and wanting more detailed guidance, they vastly preferred interpretive guidance to remediate the concerns they expressed above about additional guidance.

- **Should additional guidance be limited to an articulation of broad principles or should it be more detailed?**



- **In what format would you prefer the guidance to be?**

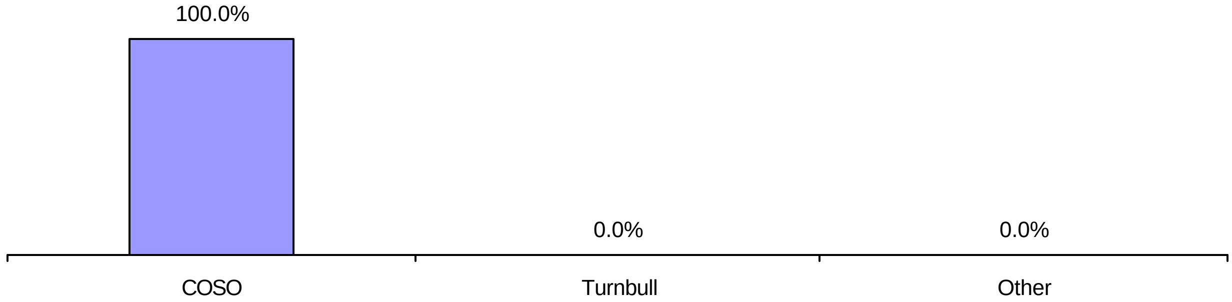


Commission rule – Reasons:
- "More authoritative."
- "To take the wiggle room out, in particular for the public accounting firms. Interpretive guidance can be manipulated and can be subject to inconsistent interpretation, whereas a rule dictates patterns of behavior."

Interpretive guidance – Reasons:
- "Because of where we stand right now. It has been a battle to get here are we do not want to start the process all over again due to differences in judgment with other professionals."
- "While there is a need for interpretive guidance in specific areas, most issuers have already developed robust processes for performing their assessment of internal controls and therefore such guidance must be sensitive to the potential rework costs and disruptive effects of new overarching and prescriptive mandates. Any new guidance should provide latitude for management to exercise its own experience and judgment in designing its assessment processes."
- "Avoid superseding other authoritative bodies."
- "Part of existing issues result from differing interpretations of existing rules and conflicts between companies applying SEC rules and auditors applying AS2."
- "Issue guidance that is broad, principles based and that focuses on providing clarifications to certain issues versus providing rules/strict interpretations."
- "Interpretive guidance will facilitate in the analysis of judgmental issues and provide a general framework that can be used to support issues of varying facts and circumstances."
- "Less formality."
- "There is a risk that if guidance is issued by the commission in the form of rules it will not allow for the exercise of judgment by management."
- "Provide interpretive guidance to maintain the ability of both management and the auditors to apply reasonable judgment."

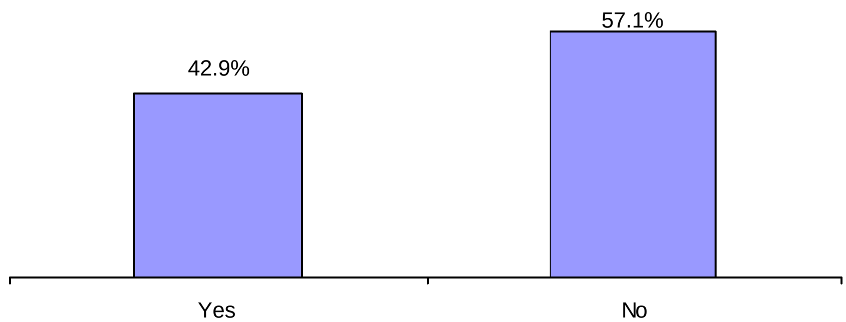
OTHER GUIDANCE FORMATS

- **Which framework did you choose to follow for the assessment?**



*Note: The majority of respondents attributed their use of COSO to its wide acceptance and comprehensiveness.

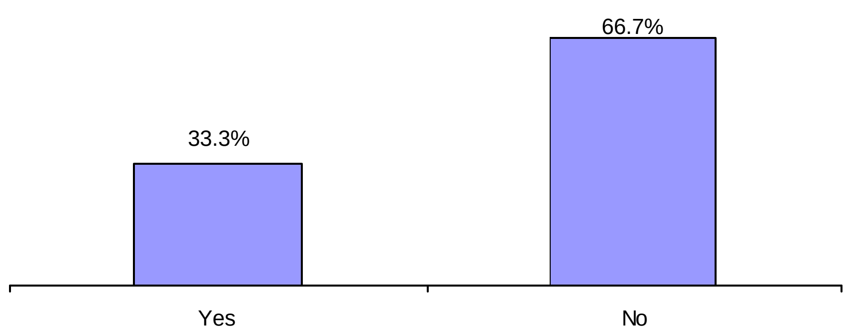
- **Could you benefit from the development of additional frameworks?**



REGARDING THE MAY 16, 2005 "STAFF STATEMENT ON MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING"

The respondents expressed a strong desire for the Commission to consider alternatives to the role and manner in which outside auditors provide attestation required by Section 404 (a) and (b) – namely, most wanted a reduced role for the external auditors.

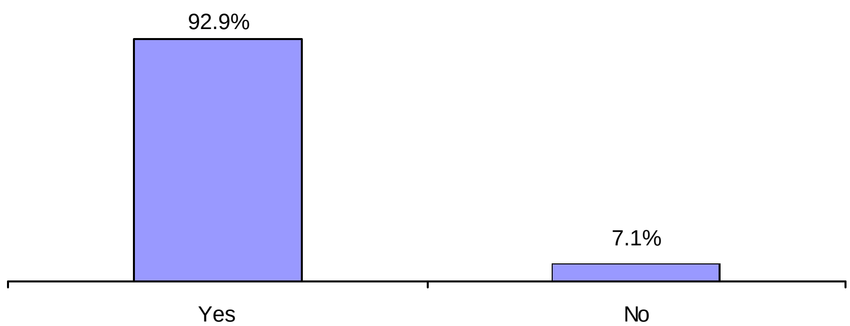
- **Should any portions of the May 16, 2005 guidance be modified or eliminated?**



- **What should be modified or eliminated?**
  - "All the areas that came out in additional SEC communication." – Energy Company

- "The May 16th guidance has proven very helpful to both auditors and registrants. This guidance should be incorporated into any SEC guidance issued to provide one grouping of SEC guidance related to internal control." – Utilities Company
- "In general the statement was very high level and did not provide enough detailed guidance to enable discussions with external auditors around scope of work." – Chemicals Company
- "In general, add more illustrative examples especially in the areas of: 1) Defining more of the basis of "reasonable assurance," specifically scope, coverage, materiality; 2) Testing low risk accounts differently than high risk accounts; 3) Testing fewer than all control steps in a process; 4) Testing some areas or processes less extensively for a given year and the possibilities of a change in focus from year to year in the context of a year specific assertion; 5) Adequate time periods in which to perform tests and regarding the samples selected; 6) Types of ongoing monitoring controls that might be relied upon in lieu of detailed testing, and the testing of the reliance on those controls; 7) Advice from auditors regarding the details of the structure and plan of management's SOX program." – Manufacturing Company

- **Should alternatives to the current role and manner in which outside auditors provide attestation required by Section 404(a) and 404(b) be considered?**



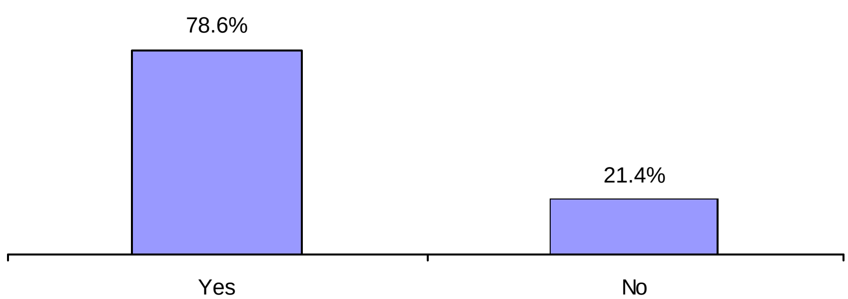
- **What possible alternative approaches should be considered?**
  - "Ideas that have been in circulation, such as: reduced auditor testing due to a history of good controls with no changes." – Utilities Company
  - "Reduced auditor role, certifications should be sufficient to ensure that controls are adequate, but removing the auditor will provide more flexibility to mgmt to ensure that the process is also efficient." – Transportation Company
  - "The requirement of two internal control opinions from the external auditors seems overly burdensome and warrants revisiting. Section 404 of the Act requires each registered public accounting firm to 'attest to, and report on, the assessment made by management of the issuer.' The Act itself does not require a standalone opinion on the effectiveness of internal controls. This requirement is the result of an SEC action. We believe this additional requirement has been a key driver in the increased cost of compliance. Compliance with the SEC rule requires a level of planning, testing and documenting by the external auditors that greatly exceeds the level required to evaluate management's assessment. If an external auditor disagrees with management's assessment, an adverse opinion on management's assessment would be expressed. The scarcity of such adverse opinions in the first two years of SOX 404 compliance suggests management assessments have been accurate and that a second opinion from the external auditor may be excessive and the incremental cost unjustified. As many US public companies continue in our third year of compliance, we request that the necessity of two audit opinions be reexamined." – Pharmaceutical Company
  - "More risk based and more integrated with the financial audit." – Telecommunications Company
  - "Audit only every 3rd year." – Energy Company
  - "Reduce the influence of external auditors on management's assessment by having a management report on controls and an audit report on controls. Another option is to allow the auditor to place much more reliance on internal audit and the previous year experience and update that with high level discussions and reviews rather than doing walkthroughs and detailed testing every year." – Insurance Company
  - "Preference is that outside auditor would not be required to complete an internal control attestation. As an alternative, would want outside auditors to rotate annual attestation requirements among clients so that not all companies would be audited each year which would provide an element of surprise to ensure focus and compliance. These preferences are based upon the idea that management is ultimately responsible for the annual assessment of ICFR." – Restaurant Company

- "1) Rotation of control testing, 2) elimination of attestation on intemal controls by external auditor and only require annual attestation on management's assessment by external auditor, 3) rotation of attestation reports by external auditor - require annual management assessment." – Utilities Company
- "Reduce auditor involvement" – Food Services Company
- "Consideration should be given to having external auditors provide an independent assessment on the internal controls over financial reporting, but not over management's assessment. This would still provide the credibility of the external assessment, but would reduce the amount of effort and associated costs for the corporations." – Chemicals Company
- "The attestation is a feature of the Act and there is no getting away from it without legislation. However, the current guidance encourages the public accounting companies to be extremely risk averse - they place more emphasis on the controls opinion than they do on the financial opinion. The guidance to the public accounting firms should be that the controls opinion is an ancillary or qualifying opinion, and that the primary focus of the audit is to assure the public that the financials are materially correct. The PCAOB should also emphasize to them that their inspections are of ALL auditing activities by the firms - and that they will get into as much trouble for errors in accounting principles and their application as they will for poor controls auditing. Of course, we would like to see the controls attestation done away with entirely so that there is only one opinion regarding the company's financial reporting, secured by a combined audit of the two functions." – Energy Company
- "Auditors should either express an opinion on the adequacy of management's assessment of internal control over financial reporting, or auditors should perform an independent assessment of those controls. They should not be required to perform both." – Manufacturing Company

RISK-BASED APPROACH

The respondents also expressed a desire for guidance to help implement a "top-down, risk-based" approach to identifying risks to reliable financial reporting and the related internal controls, especially in the form of examples. They also believed additional guidance on identifying controls that address the risk of material misstatement as well as on the appropriateness of and extent to which quantitative and qualitative factors should be used would be helpful.

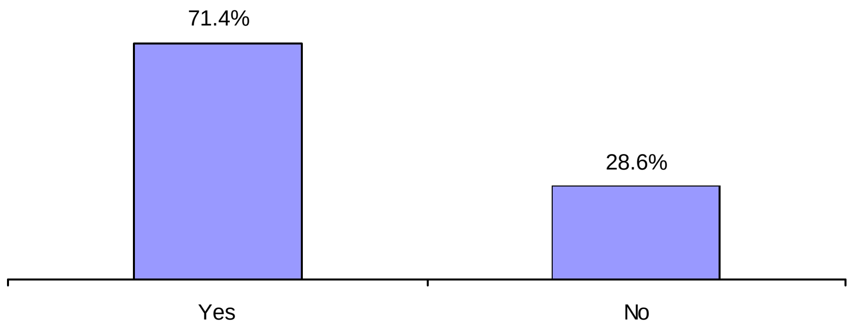
- **Is guidance needed to help you implement a "top-down, risk-based" approach to identifying risks to reliable financial reporting and the related internal controls?**



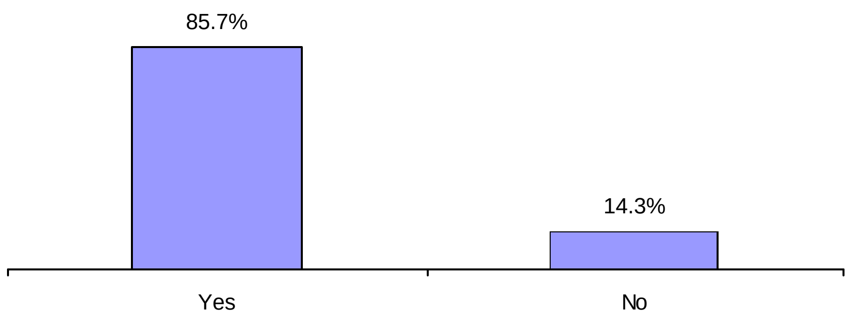
- **What type of guidance?**
  - "On how we can use control rationalization to reduce management testing of details, how a good upper level set of controls can be relied on, with possible rotation of the detailed controls." – Utilities Company
  - "Examples" – Transportation Company
  - "One area is how companies with strong entity-level controls can significantly reduce lower-level testing. Most serious and well-known failures of controls have occurred at the top, but we find that testing of controls at lower levels is the major focus of the compliance effort." – Pharmaceutical Company
  - "Guidance needs to allow auditors to do little or no work in areas where it is highly unlikely to cause a material misstatement. For example many transactional processes are of a nature that makes it very unlikely that a material misstatement would result as a result of a deficiency related to them." – Utilities Company
  - "Examples" – Energy Company
  - "Guidance in the form of examples that helps demonstrate how we can reduce the amount of transactional testing based on the assessment of entity-level controls. Guidance should show examples of how this actually works in practice." – Insurance Company

- "Guidance in the form of examples as to how entity level controls can be leveraged to reduce process control level testing would be helpful." – Utilities Company
- "First, the manner in which the risk assessment is conducted needs to be addressed. There should be guidance as to what factors need to be considered and how they are weighted. Second, materiality and likelihood are both issues which need to be clarified on a quantitative basis, as these are the primary indicators of risk and the public accounting firms now make their own materiality rules for both scoping and evaluation of deficiencies." – Energy Company

- **Would additional guidance on identifying controls that address the risk of material misstatement be helpful?**



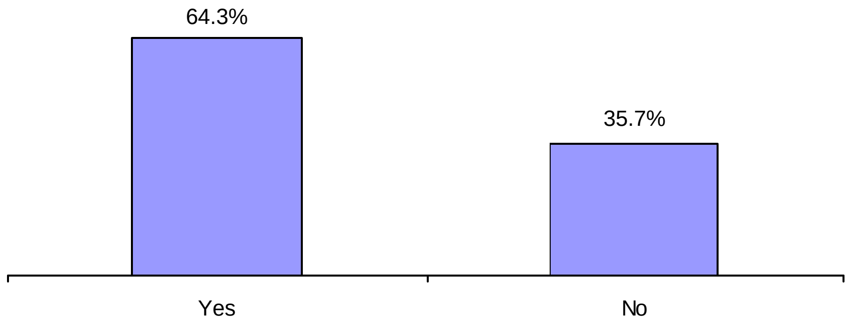
- **Would it be helpful to have guidance about the appropriateness of and extent to which quantitative and qualitative factors (such as likelihood of an error) should be used?**



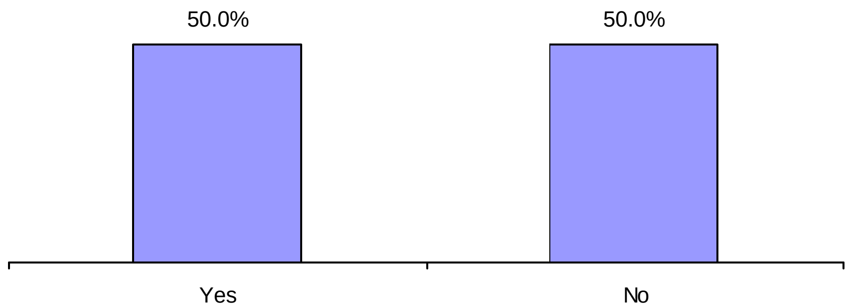
- **Which factors?**
  - "Address balance sheet errors in context of balance sheet, not income statement" – Telecommunications Company
  - "Size and nature of individual transactions; areas that are automated and have a history of clean audits" – Utilities Company
  - "We think guidance on likelihood is the most important. Again, guidance with examples would be most helpful." – Insurance Company
  - "Provide additional guidance on how to determine the potential error of a deficiency considering mitigating controls." – Restaurant Company
  - "Guidance in the form of examples as to why an account balance may be over a specific threshold but may not be considered significant would be helpful. Qualitative factors that would impact such an assessment would also be helpful." – Utilities Company
  - "Guidance on how to weigh the quantitative and qualitative factors when assessing the risk of misstatement (e.g. assessing risk that may have high dollar value impact, but low likelihood of occurrence)." – Chemicals Company
  - "This should really be a function of the types of risks which are present. For example, in our business Fixed Assets constitute a huge quantitative item but the likelihood of a misstatement or a fraud is relatively low. On the other hand, our Tax provision is relatively small quantitatively but contains huge risks due to estimating and the experience of the preparers. Every company is different - so we need a consistent, organized way to define the risk types as primarily quantitative or qualitative and then proceed from there." – Energy Company

FRAUD CONTROLS

- **Should the SEC provide guidance about fraud controls?**



- **Is there existing private sector guidance on fraud controls that you have found useful (for example, the AICPA's 2002 "Management Antifraud Programs and Controls")?**

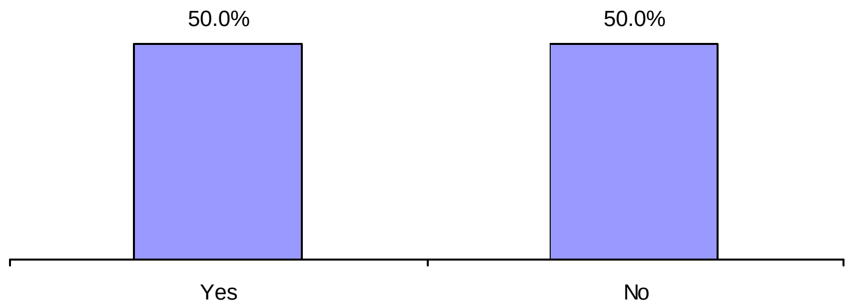


Private Sector Guidance:

- "The 2006 Association of Certified Fraud Examiners manual. But this is more practical, lower level advice."
- "AICPA guidance"
- "We found the information from the certified fraud examiners, including their definitions, to be useful. Part of the problem with fraud is it makes more sense to look at all frauds, not just financial reporting frauds so the task goes beyond Sarbanes requirements."
- "AICPA's 2002 "Management Antifraud Programs and Controls" along with SAS No. 99"
- "We use a template of required anti-fraud activities and a rating of our effectiveness in each area that was provided by our external auditors."
- "AICPA's 2002 'Management Antifraud Programs and Controls ' and external auditor's guidance."

MULTIPLE LOCATION OR UNIT TESTING

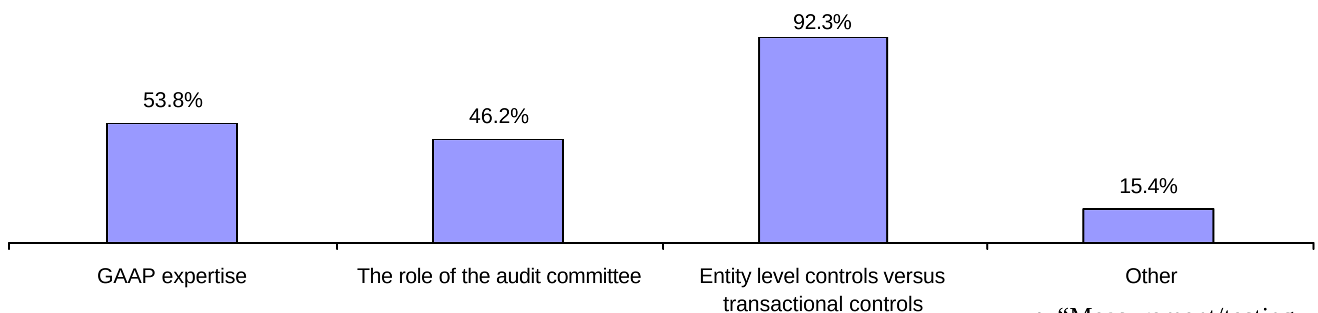
- **Should the SEC provide guidance on the topic of testing in multiple locations or units?**



ENTITY-LEVEL CONTROLS

There was a strong desire among respondents for guidance around entity-level controls versus transactional controls, especially in the form of examples.

- **What specific entity-level control issues should be addressed by the additional guidance?**



- "Measurement/testing of the control environment ("Tone at the Top")
- "General computer control framework"

- **What type of guidance would help explain how entity-level controls can reduce or eliminate the need for testing at the individual account or transaction level?**
  - "A listing of entity level controls - such as, code of conduct, antifraud program, audit committee charter - maybe a best practices list that if our company has in place, it reduces the amount of work done at the lower levels." – Utilities Company
  - "Lots of detailed examples." – Transportation Company
  - "Existence of policies and procedures and compliance to them" – Telecommunications Company
  - "Anything that would direct auditors to base their report on entity level disclosure controls rather than transaction level controls. The focus needs to be on the controls that insure that the financials are materially correct and not that each of the potentially millions of pieces are correct." – Utilities Company
  - "As previously noted, guidance that includes practical examples of how effective entity-level controls can impact transactional level testing would be extremely helpful. Also guidance on whether they believe certain entity-level controls help reduce transactional testing more than others would be useful." – Insurance Company
  - "Guidance in the form of specific examples of entity level controls and how these controls being effective can directly reduce process control testing." – Utilities Company
  - "Acknowledgement with examples" – Food Services Company

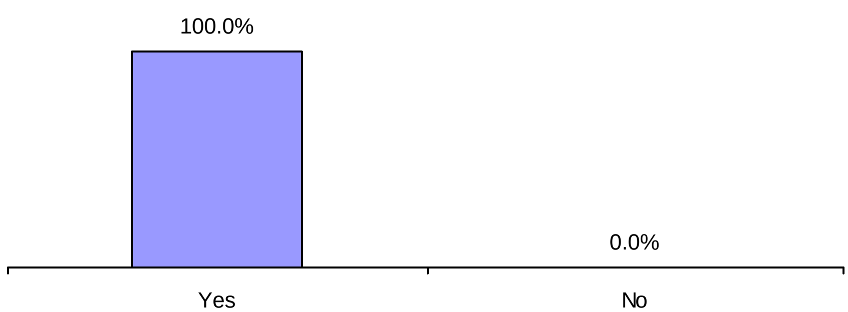
- "Guidance to enable management to more effectively rely on their entity level controls and reduce the need for detailed testing of transactional process controls. In our view, 80% of the effort is currently focused on the transactional testing with little or any reliance on entity level controls." – Chemicals Company
- "The problem is that even if you have good entity level controls they are a devil to test, and the public firms don't like that. They need to verify or accept verification that the entity level controls are in place, and then incorporate that into their risk assessment before identifying processes for testing and the severity of testing. The 2005 SEC guidance gives a road map for top down auditing - major process, financial statement account, individual account - but no one told us how to line up major process risks with entity level controls. One could make the argument that the number of entity level controls surrounding a process would indicate the general mitigation of risk around that process, but that's pretty simplistic." – Energy Company
- "1) Examples; 2) Reliance on management reviews of financial statements and management financial reporting." – Manufacturing Company

- **What types of entity-level controls have been useful in reducing testing?**
  - "Antifraud program, including a fraud risk assessment; standards/professionalism of internal audit department; training programs and communication to employees of code of conduct; addition of standard expectations of accounting practices for accounting employees for their performance review." – Utilities Company
  - "Division-level monitoring controls over low-risk areas, like fixed assets, instead of testing fixed assets at each site." – Pharmaceutical Company
  - "compliance with local SOX 404 controls" – Telecommunications Company
  - "Disclosure controls Analytical reviews" – Utilities Company
  - "We have used budget to actual controls as well as trend analysis to reduce transactional testing. In certain areas, we have also relied on a hands-on corporate level review as the key control rather than the detailed controls under it." – Insurance Company
  - "Monitoring controls/analytical analysis" – Utilities Company
  - "Business unit financial statement review checklist" – Food Services Company
  - "We have not been able to obtain concurrence from our external auditors that any of our entity level control work would allow us to reduce testing at the individual account or transaction level." – Chemicals Company
  - "Comprehensive risk assessment; relatively strong policy and procedures; strong anti-fraud and ethics programs; strong internal audit staff; comprehensive internal audit planning; existence of a dedicated Compliance group within management." – Energy Company
  - "Mostly we have relied upon entity-level controls as mitigating the severity of exceptions being evaluated rather than as a direct reduction in testing. More so we have relied upon division-level reviews and reconciliations to reduce plant-level testing." – Manufacturing Company

NEED FOR SEPARATE EVALUATIONS

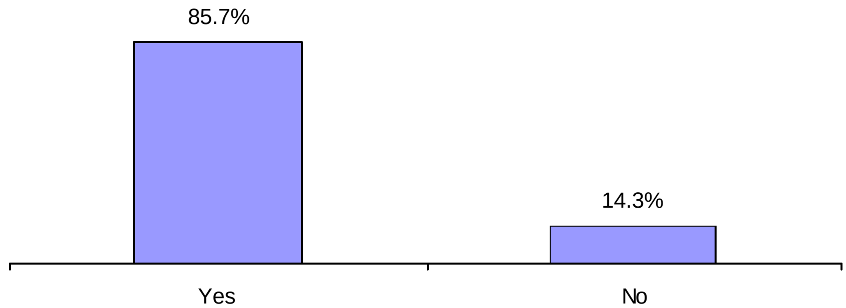
Every respondent wanted additional guidance on how management's assessment can be based on evidence other than that derived from separate evaluation-type testing of controls, and most wished for more guidance on how management's daily interaction with controls can be used to support its assessment as well as guidance on evaluating the role of different factors when determining when a separate evaluation is necessary.

- **Would guidance on how management's assessment can be based on evidence other than that derived from separate evaluation-type testing of controls, such as on-going monitoring activities be useful?**

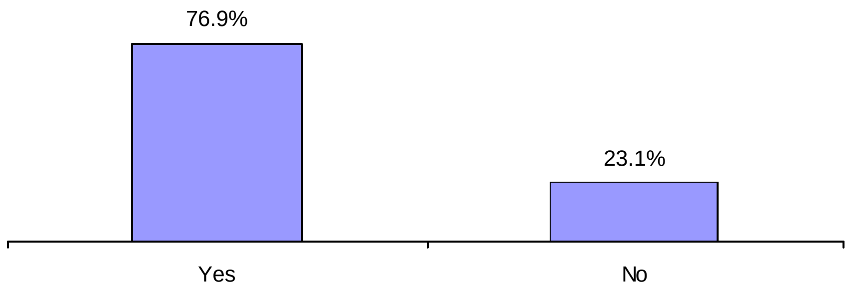


- **What are some of the sources of evidence that companies have found most useful?**
  - "Understanding of and compliance with policies and procedures" – Telecommunications Company
  - "We have looked to use some level of detailed and documented management reviews which include some level of detailed review of underlying controls" – Insurance Company
  - "Minutes of management committee meetings" – Food Services Company
  - "Internal audit reports and finding resulting from these" – Chemicals Company
  - "CONTROL SELF ASSESSMENT is absolutely essential." – Energy Company
  - "Reviews of financial statements and other management financial reporting at corporate and divisional levels." – Manufacturing Company

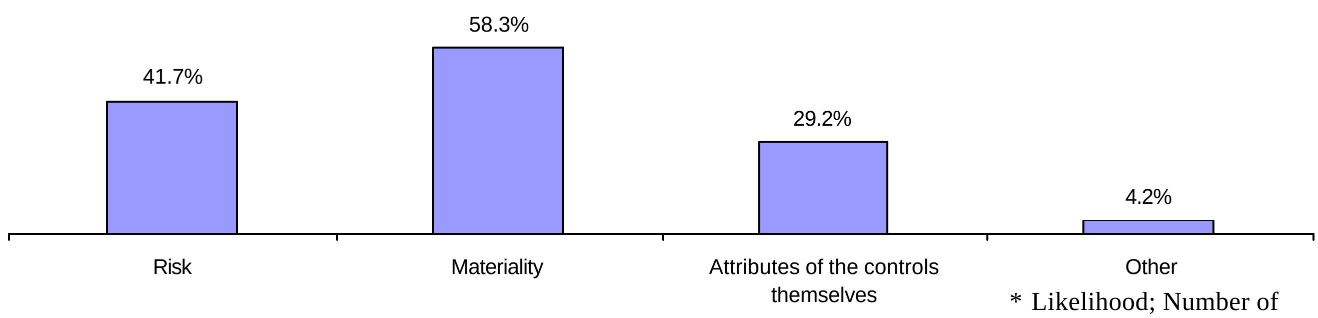
- **Would guidance about how management's daily interaction with controls can be used to support its assessment be useful?**



- **In determining when a separate evaluation is necessary, would guidance be helpful in evaluating the role of different factors in making that judgment?**



- **Which factors would you be interested in having more guidance on?**

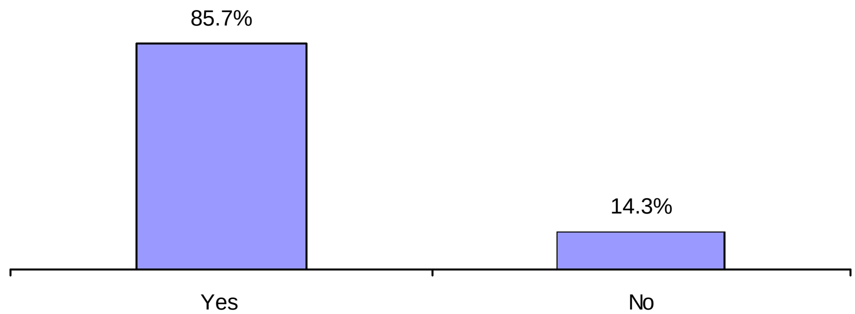


* Likelihood; Number of locations in which the processes and controls exist; Previous history of errors, deficiencies, or misstatements

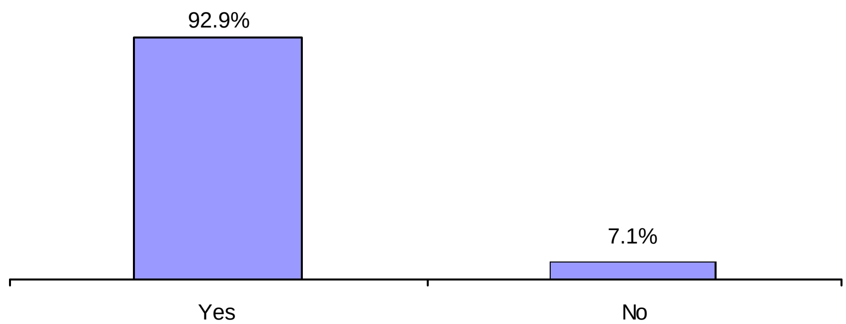
TIMING OF TESTING

Most respondents would like guidance on the timing of management testing of controls as well as on updating evidence and conclusions from prior testing to the assessment "as of date."

- **Would guidance be useful on the timing of management testing of controls?**



- **Would guidance on updating evidence and conclusions from prior testing to the assessment "as of" date be useful?**



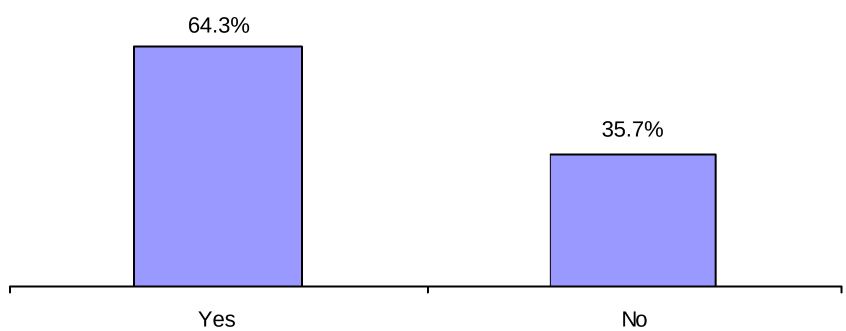
MANAGEMENT EVALUATION

- **What type of guidance would be appropriate regarding the evaluation of identified internal control deficiencies?**
    - "Lots of detailed examples of exceptions that result in no control deficiency, control deficiency, significant deficiency and material weakness." - Transportation Company
    - "While the direction provided by AS2 and the Framework for Evaluating Control Exceptions and Deficiencies is helpful for deficiency evaluation, several open issues remain. For example, how should deficiencies in information technology general controls be aggregated? Should the potential impact of unremediated deficiencies be aggregated with remediated deficiencies? Should aggregation by significant account include absolute values or is it appropriate to net the effects of offsetting deficiencies?" – Pharmaceutical Company
    - "Currently most companies use a framework developed by the audit firms that is very complex and difficult to apply. We had a deficiency in 2005 and our audit firm admitted that the framework for assessing entity level controls did not work and we ended up using "common sense" to assess the potential impact. Thus, a framework that is practical to apply would be helpful." – Insurance Company
    - "Provide additional guidance on how to determine the potential error of a deficiency considering mitigating controls." – Restaurant Company
    - "There is significant guidance about how to evaluate deficiencies; however, the guidance could be enhanced by providing examples of how qualitative attributes should be considered in assessing control deficiencies." – Utilities Company
    - "Projection or extrapolation guidance." – Food Services Company
    - "Guidance on how to weigh the quantitative and qualitative factors when assessing the risk of misstatement (e.g. assessing risk that may have high dollar value impact, but low likelihood of occurrence). Also, how to apply aggregation of deficiencies is not clearly articulated." – Chemicals Company

- "Most importantly, we have got to let a "prudent official" kick wholly inconsequential deficiencies out of the evaluation framework and out of the formal deficiency-report-remedy-retest process. In other words, the first decision in Framework #3 Chart 2 (where "Box 7" now resides) should be whether the item is a "deficiency" at all. We do this informally and our externals have agreed that it is OK to do so." – Energy Company

- **What issues or key considerations are there when evaluating deficient controls that have only an indirect relationship to a specific financial statement account or disclosure?**
    - "We encountered the question of whether these types of deficiencies can be significant or material and it was difficult to conclude. Maybe the definitions of significant and material could address controls that have an indirect impact on financial statements or controls." – Insurance Company
    - "Measuring the potential error." – Restaurant Company
    - "The need to balance mitigating controls." – Food Services Company
    - "Guidelines around in what situations could a deficient control that has only an indirect relationship to specific financial statement accounts or disclosures be anything more than a control deficiency." – Chemicals Company
    - "You simply have to prove the degree of removal. That's where likelihood of misstatement or fraud increases or diminishes. Second, the existence of an intervening key control that is functioning should serve to mitigate a failed control with a more remote relationship to the financials." – Energy Company
    - "Whether there are "cardinal" deficiencies that would automatically be regarded as material weaknesses or significant deficiencies" – Manufacturing Company

- **Would guidance be helpful regarding the definitions of the terms "material weakness" and "significant deficiency?"**



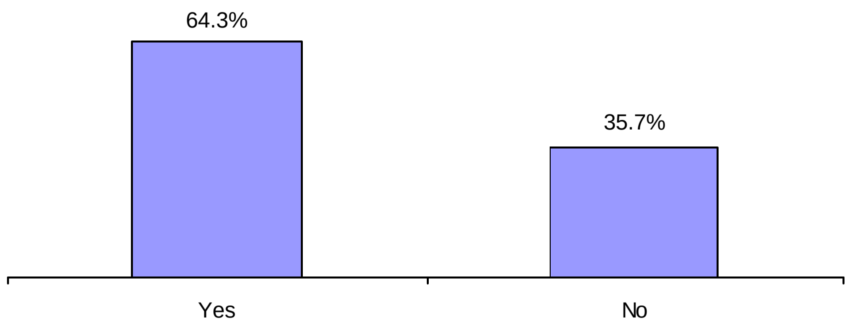
- **What issues should be explained in the guidance?**
    - "Deficiencies are required to be evaluated for significance, individually and in the aggregate. Significance is primarily measured in terms of the potential impact on the financial statements. AS2 indicates that the assessment should consider both quantitative and qualitative factors, but does not distinguish between the assessment of deficiencies that affect the income statement and the assessment of deficiencies that only affect the balance sheet (reclassifications between account balances). The management guidance should indicate that the quantitative thresholds used to evaluate deficiencies should be determined by the financial statement impacted by the deficiency. Furthermore, the methodology being used to determine materiality, as used to evaluate control deficiencies, is not being consistently applied in practice. In particular, management guidance is needed for the measurement of 'more than inconsequential'. Although common approaches to this quantification problem are being broadly adopted, there is insufficient guidance to provide authority for such an approach. Without such guidance, issuers must essentially agree with external auditor judgments on materiality, which may be set arbitrarily low." – Pharmaceutical Company
    - "Application of more common sense as to effect on users of financial information." – Telecommunications Company
    - "We think there is merit in leaving some flexibility in these definitions as it would be difficult to address all potential issues. Our concern arises more from the way the PCAOB may react to auditor's conclusions about the magnitude of control deficiencies." – Insurance Company
    - "Currently follow AS2 since no registrant guidance exists. The basic definitions are well understood, but applying them in practice has proven difficult. Further clarification with examples would assist with analysis of deficiencies." – Utilities Company
    - "Guidance relating to determining the likelihood of an error occurring in the financial statements where there are compensating controls. As well, providing more clarity around the definition of remote." – Chemicals Company

  - o "Determination of MATERIALITY and the concept of corporate-level materiality versus local materiality. At the end of the day, it's all about whether the public would be mislead to the extent that they would not have invested in an equity if the deficiency or misstatement were known to them. Information as to what to do when you find a "significant deficiency" (other than to document it for potential aggregation) would also be useful." – Energy Company

ERRORS IN FINANCIAL STATEMENTS

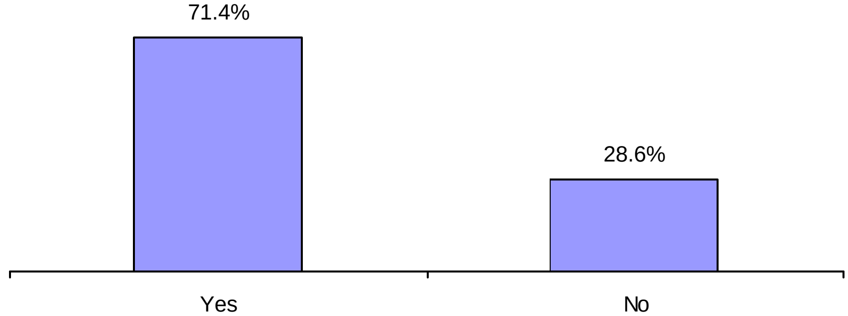
Most respondents indicated an interest in receiving guidance on evaluating whether or not a material weakness has occurred when the need to correct a financial statement error as part of the financial close process arises, and even more would like guidance on evaluating whether or not a material weakness occurred when the restatement of previously reported financial information is necessary.

- **In cases where there is a need to correct a financial statement error as part of the financial statement close process, would guidance on evaluating whether or not a material weakness also occurred be helpful?**



  - "Guidance on balance sheet only errors would be helpful - i.e., how measure materiality other than using income statement based metric"
  - "The occurrence of an error and when and how it is or may be detected will depend on the nature of the processes and controls companies have in place. When an error is identified, it usually indicates a deficiency at some point in the process but the fact that it was identified and corrected indicates that a compensating control mitigates the risk of error."
  - "Provide factors to consider."
  - "We believe that errors identified in the financial statement close cycle are part of the system of internal control and have been able to be assessed appropriately. However, an area that could use further classification is how to assess reclassifications detected in the financial statement close process versus those which have an impact to net income."
  - "Our view is that if a misstatement is caught during the financial close, the process worked. The deficiency which caused the potential error should be evaluated on its merits. The firm should not be penalized because a higher level control functioned as designed even if the lower level control failed. However, some public accounting firms disagree with this."

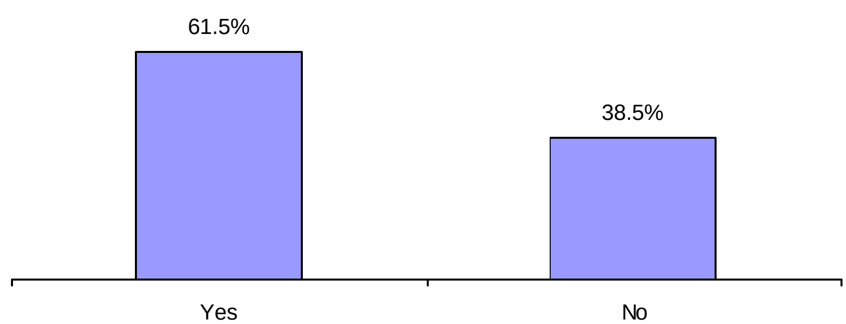
- **In circumstances where a restatement of previously reported financial information is necessary, would guidance on evaluating whether or not a material weakness also occurred be helpful?**



IT CONTROLS AND COMPLIANCE

- **How has your company used technology to gain efficiency in compliance? (e.g. automation and benchmarking)**
  - "We leverage a software package, Paisley's Risk Navigator, to serve as a global repository of our internal controls documentation. We are currently implementing software to manage user access and segregation of duties within our ERP system. We are considering implementation of a continuous controls monitoring solution to ensure real-time control over master data and transaction processing." – Pharmaceutical Company
  - "We have not used technology to gain efficiency in assessing our controls." – Insurance Company
  - "Utilized a portal tool to design workflow for quarterly certification process, to provide a repository/document sharing source as well as means to maintain the linkage between financial elements/processes & objectives/risks/controls, & to automate the testing/remediation request process including follow up." – Restaurant Company
  - "Baselining standard reports used to support controls on a rotational basis. Additionally, we have pushed to look for efficiencies where automated controls can replace manual controls. This proved particularly useful when we consolidated general ledgers into one application." – Utilities Company
  - "Limited use of checklists and templates" – Food Services Company
  - "We do not retest all general application controls or system generated reports. We rely on testing of the change control process to ensure all system changes are adequately tested before implementation into our production environment." – Chemicals Company
  - "We replaced five old systems with SAP. We also work hard to leverage automated versus manual controls, because the "time in operation" after remedy of a deficiency for an automated control is nil. We are also going to install new SOX software." – Energy Company
  - "Automation of testing workflow and results capture; documentation repository; reporting and tracking the overall SOX program; detailed attributes and hierarchies of controls, accounts, assertions, etc; data warehouse of SOX data; presentation layer for auditors to review management's program, documentation, and test results" – Manufacturing Company

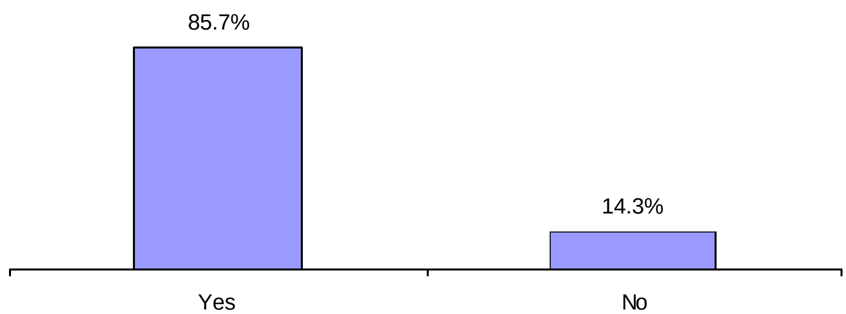
- **Would you like guidance on determining which IT general controls should be tested?**



- **How is your company determining which IT general controls could impact IT application controls directly related to the preparation of financial statements?**
  - "We document the same set of IT general controls for all in-scope IT applications. The manner in which these IT general controls are tested differs however. Last year we risk-rated all of our in-scope IT applications (~100) so our external auditors could tailor their testing efforts accordingly. This year we are piloting an embedded self-assessment approach for SOX compliance over the low-risk applications." – Pharmaceutical Company
  - "Using an income statement and balance sheet materiality as well as likelihood of error risk matrix" – Telecommunications Company
  - "We considered which controls were important around the key areas of operations, security, development lifecycle and applications and developed a standard set of controls that were adopted by each of our data centers. We did not try to directly tie general controls directly to their impact on application controls." – Insurance Company
  - "Performing GCC work only on GCCs affecting applications supporting in-scope business processes that impact financial statement preparation." – Restaurant Company
  - "We evaluate the processes that impact financial reporting, identify the IT dependencies and test IT general controls related to the applications that link up to the identified dependencies. All servers on which SOX relevant applications reside, and their corresponding databases, operating systems, network components, and physical data center locations, are deemed SOX relevant." – Utilities Company

- "Reliance on auditing standard" – Food Services Company
- "By applying a judgment based evaluation of the potential risk of an error in the financial statements resulting from a failure in those controls." – Chemicals Company
- "We agreed these issues through judgment and trial and error with our internal and external IT auditors. It was not easy." – Energy Company
- "We determine which controls pertain to the systems and applications that affect the financial reporting and test only those. We exclude IT operations and applications supporting business units or control groups whose processes are not in scope for the year." – Manufacturing Company

- **Have you been using IT frameworks as a guide in conducting the IT portion of your assessment?**



*The majority of those answering "Yes" use COBIT, though 2 use frameworks from their auditors.

DOCUMENTATION

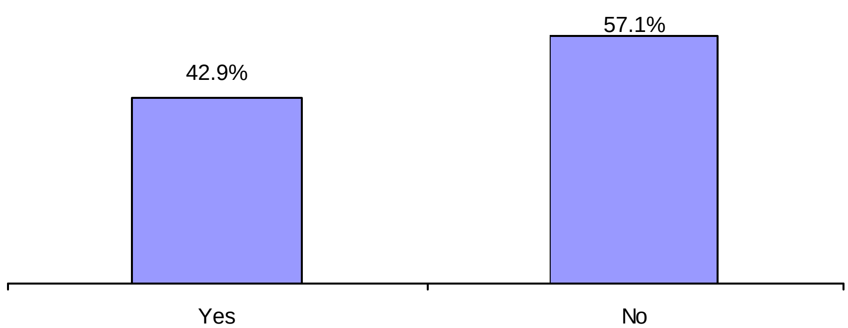
- **What guidance is needed about the form, nature and extent of documentation that management must maintain as evidence for its assessment of risks to financial reporting and control identification?**
  - "None for us – may be more of an issue for small companies." – Pharmaceutical Company
  - "In our experience, guidance in the form of examples would be helpful to companies to understand the form and extent of documentation required around the process of assessing risks to financial reporting. Once risks are adequately documented and assessed, we believe companies generally understand the form, nature and extent of documentation needed to document most controls, particularly transactional level controls. Guidance on how to assess risk and document the assessment of certain entity-level controls, particularly governance type controls, would be useful, particularly if examples were provided." – Insurance Company
  - "Not aware of any guidance which outlines what is required; however, not sure that guidance in this area would be beneficial since it seems that in working through 404, auditors and registrants have determined what an adequate level of documentation is - flowcharts, narratives, control matrices." – Utilities Company
  - "Limited." – Food Services Company
  - "Preferably guidance would confirm that the process risk assessment is judgmental and only minimal documentation is necessary to support management's conclusions." – Chemicals Company
  - "Risk assessment documentation depends largely on the methods we referred to in section 5. The methods will determine the documentation required. Controls documentation is straight forward. The documentation must be comprehensive due to the need to keep the compliance group impartial and to document how controls came into being and how they have changed over time." – Energy Company
  - "Conceptual and principle-based guidance with examples." – Manufacturing Company

- **What factors need to be taken into consideration (e.g. entity factors, process, or account complexity factors)?**
  - "Entity factors." – Food Services Company
  - "Account complexity, non-routine or manual processes, requires judgment or estimates, number of transactions, recent changes in process." – Chemicals Company
  - "The specific factors we take into account are: 1) Materiality to financial statements; 2) Transaction volume; 3) Organizations and locations involved; 4) Safeguarding of assets; 5) Decision making, judgments or estimates required; 6) Non-routine transactions; 7) Complexity of transactions; 8) Employee experience required; 9)

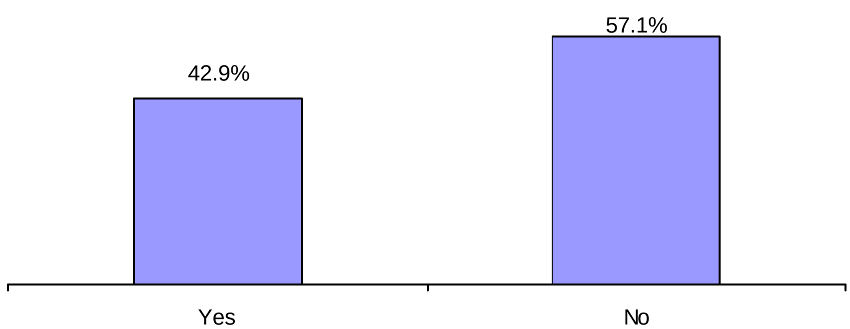
Segregation of duties required; 10) Business trends involved; 11) Availability and frequency of information; 12) IT systems involved." – Energy Company
  - "Consider the suitability of using documentation that had been prepared for other purposes versus SOX-purposed documentation. Consider the auditor's requirement to perform walkthroughs and the implication on process documentation. Consider the reliance on normal operating department self-assessments and reviews and the documentation required in order to test the effective performance of such reviews." – Manufacturing Company

- **What guidance is needed about the extent of documentation that management must maintain about its evaluation procedures to support its annual assessment of internal controls over financial reporting?**
  - "Management should maintain evidence to support and defend its annual assessment of the effectiveness of its internal controls over financial reporting. This generally includes an analysis demonstrating adequate coverage of control assessment, documentation of these controls including the results of testing controls and an analysis of control deficiencies to assess potential impact of these deficiencies on the financial statements. To the degree the Commission expects management to create and retain additional documentation above what is intuitive to a company, this should be outlined in new guidance." – Insurance Company
  - "Limited." – Food Services Company
  - "Guidance identifying at least the minimum amount of documentation and its nature." – Chemicals Company
  - "Lots. We honestly feel that we invented everything we did in this area for 2004. We did it by combining bits and pieces of guidance, various white papers, input from peers and experts and our own common sense, but it was by no stretch of the imagination an organized effort. We maintain comprehensive records of our framework, our self-assessments and our controls audits. We put together a comprehensive evaluation form for each deficiency surviving at year end based on a model we got from a peer company. There are no real standards as to the elements required. For the overall assessment, we describe our concepts, methods and results in detail. For year end deficiencies, we put together a series of coverage and incidence charts which prove that there are no concentrations or aggregations occurring amongst the deficiencies and discuss our reasoning for making the final conclusion. We created the yearly assessment straight out of our heads, although our external auditors did like it." – Energy Company
  - "Guidance as to whether process documentation must be specifically reviewed each year. Guidance as to the extent of annual documentation of program description, meeting minutes, etc versus having standing SOX program procedures and policies." – Manufacturing Company

- **Is guidance needed for IT controls documentation?**



- **Is guidance needed for documentation of IT controls testing?**



ADDITIONAL COMMENTS

- **On what additional topics would you like guidance?**
  - "SAS 70 reports, particularly around qualified opinions and the rollforward period. The current literature does not provide sufficient guidance on the testing requirements when a SAS No. 70 report is received with a qualified opinion. The guidance does not clearly define the issuer's and external auditor's testing responsibilities when a qualified opinion is received in a SAS No. 70 report and the service provider's deficiencies are subsequently remediated prior to the issuer's year-end. As SAS No. 70 reports are typically received in close proximity to year-end, this poses a particularly difficult problem for issuers, as it leaves little opportunity to respond to reported exceptions. If the service provider's external auditor does not update the SAS No. 70 report, we do not believe that the issuer should have the responsibility to test the remediation of the deficiency at the service provider. We believe that reasonable assurance can be achieved by obtaining a stub period representation letter from the service provider." – Pharmaceutical Company
  - "Guidance on end user computing would be helpful." – Insurance Company
  - "Provide example of common entity level controls including how they operate and are tested." – Restaurant Company
  - "Detailed guidance for management on: Evaluation and testing of controls over Excel spreadsheets used in performing key controls; Necessity of completing process walkthroughs each year; reliance on the work of another audit firm." – Chemicals Company
  - "Note that some of these items are high level (SEC could opine) and some are lower level (the SEC could identify a reputable source or sources to develop this information). 1) Risk assessments; by whom performed and by whom approved as a best practice. 2) Standard definitions of a "Key" control and a "Critical" process. 3) Use of the information processing objectives (Completeness, Accuracy, Validity, Restricted Access or CAVR); our externals require us to associate these values to individual controls and ensure that at least one key control with each value is present in a process. We have never seen any standard that refers to this. 4) Standards for INTERIM evaluation of deficiencies to determine (a) whether a full evaluation to identify a likely material weakness is necessary and (b) to establish interim materiality as opposed to annual materiality, and when that is appropriate to do so. 5) Spreadsheets; identification of testable or "key" spreadsheets. Allow a manual control at the same level to render testing of a spreadsheet unnecessary." – Energy Company
  - "Standards for the transparency of work performed by auditors regarding their reliance on management's work, the time/work performed regarding SOX versus the financial statement opinion or jointly under an integrated audit." – Manufacturing Company