BROWN-FORMAN

PAUL RODE
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September 18, 2006

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

Re: File Number S7-11-06, Concept Release Concerning Management's Reports on Internal Control over Financial Reporting

Dear Ms. Morris:

Our company is very pleased that the SEC has shown a strong interest in continuously improving and refining the Sarbanes-Oxley section 404 (SOX) standard. The SEC roundtable on April 13, 2005 identified a number of important issues, and the SEC provided additional guidance that improved the efficiency of complying with SOX in year two. The guidance issued after the 2005 roundtable enabled our company to reduce the number of key controls through a more focused, risk based approach and allowed our outside auditor to rely more heavily on the work of our Internal Audit department. These positive changes made our SOX 404 compliance efforts more efficient.

The roundtable held on May 10, 2006 further demonstrated the SEC's willingness to listen to concerns and to find ways to further improve the process. **While we have seen positive changes resulting from the SEC's actions following last year's roundtable direction, our company still believes that further improvements can be made. We appreciate the opportunity to again provide feedback to the**

SEC about our practical SOX experiences and ideas as to how SOX 404 compliance can be further refined.

Executive Summary

It is our belief that the level of effort required to comply with SOX 404 exceeds the intended target of providing "reasonable assurance" regarding the effectiveness of a company's internal controls. This results in disproportionate cost to public companies vis a vis the benefit derived by the investing public. The issue is not just "are costs too high?" but "who benefits from the additional work done and is that benefit significant?" By taking essentially a "one-size fits all" approach (recognizing that the smallest companies have received an exemption,) the SEC's current approach favors saturation bombing, with many innocent casualties, versus strategic pin-point bombing, designed to attack key risk areas.

While costs have moderated some from the first year of implementation, we believe the requirements as stated currently in Audit Standard No. 2 (the "Standard") continue to cause external auditors to do more than is required to meet the spirit of SOX 404. Our company, with revenue of $2.4 billion, paid outside audit fees of $1.3M related to fiscal 2006. Our outside audit costs for fiscal 2006 represent 173% of what we paid to our outside auditor prior to SOX 404 in fiscal 2004. While the number of hours spent on SOX by our outside auditor decreased this past year, hourly billing rates have increased significantly to cover the increased demand in the marketplace for auditors with SOX 404 expertise and, we believe, to compensate for increased risks felt by such firms with respect to the audit engagement.

We believe that cost of compliance can be reduced, and protection of investors improved, by the SEC issuing clarification guidance on a number of topics. The Standard as written continues to leave far too much room for interpretation, and by doing so, generally results in more work being done than is necessary. Stated differently, the less precise the SEC's guidance, the greater the margin for differing interpretations of what is required to meet it, and the higher the cost for the work performed. The external audit firms continue to be highly risk adverse, and the vague nature of much of the Standard will continue to require excess documentation and testing, and create an increased scope of work until better, more detailed guidance is provided.

Specifically, Brown-Forman urges the SEC to take the following actions with respect to SOX 404:

- Issue revised and detailed guidance based on risks associated with various aspects of a company's business model as opposed to different sets of rules for different companies;
- Provide more specific guidance detailing how to evaluate deficiencies, and consider abandoning multiple classifications of deficiencies in favor of focusing on material weaknesses, leaving to management the discretion as to how to communicate lesser deficiencies to its audit committee;
- Clarify the definition of what constitutes strong entity wide controls and how strong entity wide controls may lessen the transactional testing requirements;
- Permit the outside auditor to rely more heavily on work performed by the internal audit function, including areas such as the control environment and general computer controls;
- Issue additional clarification for implementing a risk-based approach;
- Revise annual testing requirements to allow for rotation of testing every two or three years and eliminate the requirement to walkthrough each major class of transaction annually; and
- Reduce the amount of work performed for the financial statement audit.

One Set of Detailed Guidance Should Be Issued

In Questions one through ten of the Concept Release, the SEC asks if further guidance is warranted, and if so, what type of guidance? **We encourage the SEC to issue one set of detailed guidance applicable to both management and the external auditor.**

While separate guidance for management may improve efficiencies for management, we do not believe that this will foster overall efficiency gains, because such separate guidance could impede reliance by the external auditor on the work performed by Internal Audit. At our company, we make every effort to maximize the reliance by our external auditor on SOX work performed by our Internal Audit group. Any work not performed by our Internal Audit group will instead be performed by our external auditor at a much higher cost. Since both internal and external audit work is ultimately aimed at the outside auditor's attestation, having separate sets of guidance creates unnecessary inconsistencies and effort.

Additional Guidance Needed for Deficiency Classifications

Identifying control deficiencies involves a difficult and subjective process in which the deficiencies are identified as "control deficiencies", "significant deficiencies" or "material weaknesses." Our company and outside auditor have utilized "A Framework for Evaluating Control Exceptions and Deficiencies" published in December 2004 to classify control deficiencies.

While subjectivity can never fully be removed from the deficiency evaluation process, we believe that in many instances, because of Internal Audit's knowledge of our business, as well as the existence of complementary controls and our entity wide controls, we often can assess very quickly whether a deficiency can ultimately result in a material weakness. However, in the current SOX 404 environment, even after we have made such a conclusion, a great deal of effort is nonetheless spent categorizing and documenting control deficiencies.

We believe that the SEC needs to reassess the necessity of having three classifications of deficiencies. To be sure, shareholders should be informed as to material weaknesses, but knowledge of minor control deficiencies, or those that are the consequence of unintentional, human error does not benefit investors. **We recommend that the SEC focus only on material weaknesses, and allow the Company to determine how lesser deficiencies are communicated.** With this approach, we would recommend that we track and communicate all deficiencies to our outside auditor so that issues can be assessed and aggregated as needed.

If the SEC decides that the three deficiency classifications should remain, we would encourage the SEC

to more clearly define the parameters management should use to categorize control deficiencies.

The most significant factor that warrants further guidance is the concept of materiality. Our audit firm has advised that an item is significant if it exceeds 0.5% to 1% of net income, or if other qualitative risks exist. **Our company believes this threshold is too low and does not meet the spirit of reasonable assurance. We recommend a higher threshold, such as 2.5% of net income. This would approximate half of materiality as defined by SAB 99 (generally 5% of net income). We would also recommend that the SEC issue guidance on deficiency aggregation and assessing general computer control deficiencies.**

<u>More Guidance Needed on Entity Wide Controls</u>

Some may argue that the entity wide controls are the most important controls to document and test. In the frauds at Enron, Worldcom and others, it wasn't the transactional controls that failed, but rather senior management circumvented the control structure. However, a majority of the work completed to assess our internal controls for SOX 404 is the documentation and testing of detailed, transactional based controls. This approach results in excessive documentation and testing without providing much additional assurance that our controls are effective.

Currently, the COSO framework provides some examples of entity wide controls, but determining which controls directly impact "financial reporting" is challenging without clear guidance. Additionally, the control environment components are often difficult to assess. For example, COSO states that the control environment is driven by a company's people, and individual attributes including integrity, ethical values and competence are critical to the environment. But, how do we measure these attributes and against what standard? COSO also states that the entire financial statement process should be monitored. What is sufficient monitoring, and at what level of detail is required?

To realize a more effective and efficient effort on SOX 404, we believe the SEC needs to provide a clearer definition or standard of what entity wide controls should be tested, and give the external auditors the flexibility

to rely on the work of Internal Audit for lower risk entity wide controls, even if the reliance is minimal. Once a clear standard exists for measuring the effectiveness of the control environment, we believe a company with strong entity wide controls should experience reduced detailed transaction control testing (for SOX) and substantive work (for the Financial Statement audit) performed by our auditor.

More Reliance on Work of Internal Audit

Based on guidance from the PCAOB after the April 2005 SEC roundtable, our outside auditor increased its level of reliance on the work of our Internal Audit group. While this was a step in the right direction, we still believe more reliance is needed. Our auditor is currently using a combination of independent testing (duplicating management's testing), re-performance of Internal Audit's tests (also duplicative testing), and complete reliance on Internal Audit testing. However, what is the proper reliance "target" for an auditor to use? Does it vary based on the company's risk profile? Are the external auditors required to independently test at least 50% of the key controls so that their work "stands on its own?" At a minimum, control testing could be rotated for lower risk controls, especially when a competent, internal audit function is present.

We suggest that the SEC clarify its guidance on the 50% standard with respect to the amount of reliance an outside auditor can place on the work of Internal Audit. By providing additional guidance, management and the outside auditors will understand more clearly where they can rely on the work of Internal Audit.

Clarity Needed for Risk Based Approach

The definition of materiality plays a major role in determining the scope of work for SOX. To date, the firms generally assume all financial statement line items and footnotes included in the annual report should be documented and tested for SOX. Guidance provided by our external auditor suggests a percent coverage of at least 50% (i.e. transactions flowing through key processes and controls tested account for greater than 50% of the financial statement line item) for each financial statement line item with a preference for coverage of greater than 70%. By using these mainly quantitative measures, lower risk accounts and footnotes often get too much attention.

We believe the SEC should issue clarifying guidance that details the minimal requirements for 1) materiality in determining which financial statement lines items and footnotes require documentation and testing, and 2) specific financial statement line item coverage. This additional guidance will ensure the proper focus on critical areas to attain reasonable assurance on internal control effectiveness.

The Walkthrough Requirement for each Major Class of Transaction Should Be Modified

The Standard requires the external auditor to perform an annual walkthrough for each major class of transaction. After the first year (and assuming no major changes have occurred since the last assessment), we believe that performing walkthroughs on 100% of all major processes does not significantly add value to the assessment process and results in significant inefficiencies with SOX compliance.

We fully appreciate the need for the external auditor to validate that management has documented processes and key controls accurately. However, is it necessary for the outside auditor to walk through every “major class of transaction” every year? We believe the auditor can achieve this goal by performing a mix of walkthroughs and testing of each process without having to either 1) perform walkthroughs of 100% of major transactions or 2) test each and every key control. We believe the risk of inaccurate process documentation to be low considering that the external auditor will continue to test key controls or independently re-perform work completed by Internal Audit.

We recommend that the SEC provide the auditor more flexibility to rotate process walkthroughs, testing and reliance on Internal Audit performed walkthroughs/testing in order to gather adequate coverage across a process, but not cover every subcomponent of the process every year. We believe using this approach will improve overall compliance efficiency for all parties without creating additional risk of inaccurate financial disclosure.

<u>Annual Testing Requirements Should Be Revised</u>

The amount of testing required on an annual basis to satisfy the standard results in significant, misplaced costs to our company. Currently, the Standard requires annual testing of every key control by management, with redundant testing by the outside auditor. Further, the "as of" testing requirement forces us to re-test controls during the last 60 to 90 days of the fiscal year, resulting in some tests being performed multiple times in a given fiscal year. These testing requirements result in a significant devotion of resources to duplicative testing as opposed to time spent making the internal control process more efficient.

We believe that management and the external auditor should be given the flexibility to rotate the testing of controls to every other year for low and medium risk controls. This approach is especially effective if controls were successfully tested in the prior year and the company exhibits a strong control environment in the eyes of the external auditor.

Additionally, the SEC should provide more specific guidance as to the requirements for "update testing", or consider changing the "as of date" requirement for reporting. The guidance should encourage the outside auditor to assess the internal control change monitoring process in place by management, and give management and the auditor the flexibility to test throughout the year without having to update controls at year-end. By doing so, we believe the effort required to satisfy the testing requirements of Section 404 can be implemented in a more cost-effective manner

<u>SOX Procedures Should Result in Reduced Work on the Financial Statement Audit</u>

With the increased understanding and testing of internal controls by the outside auditor for SOX, our belief was that the amount of work performed to support the financial statement audit would decrease. This expectation was further strengthened by the SEC's guidance in May 2005 that stated that "we expect the internal control audit to be better integrated with the audit of a company's financial statements." **Our experience indicates that the amount of**

audit work performed has not declined, and in fact, has increased compared to pre-SOX.

As stated earlier in this letter, the SOX review tends to focus heavily on detailed transactional processes such as disbursements and fixed assets. To satisfy SOX, management and the audit firms are testing controls in these areas much more intensively than ever before. However, for the financial statement audit, substantive work, such as a thorough unrecorded liabilities test, still occur. Other examples include testing fixed asset acquisitions, confirming a large number of cash and accounts receivable balances, or reviewing manual journal entries for fraud. We realize that you can't abandon these tests entirely, but we do believe that the amount of substantive work in general has not declined appropriately in relation to the increased control testing now being performed.

We strongly urge the SEC and PCAOB to identify ways to improve the "integrated audit" approach to minimize the overall work performed, and issue specific guidance to the audit firms on areas where they can reduce their work, and yet fully ensure the maintenance of strong internal controls. Focus should not only be on SOX, but on ways the overall effort on the financial statement audit can be reduced. The PCAOB should concentrate its review on making sure the financial and internal control audits are properly integrated, and it should communicate common audit issue "themes" so that all firms can improve.

Closing

We would like to commend the SEC for its efforts to date and its willingness to solicit suggestions for improving the effectiveness of SOX section 404. We hope our suggestions along with others you receive will assist the SEC in improving and refining the Standard.

Please feel free to contact us for clarification. We are pleased to participate in this process to moderate these standards.

Sincerely,

Jane Morreau
Vice President and Controller

Paul Rode
Vice President and General Auditor