NASDAQ®

November 2, 2006

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

Re: File Number S7-11-06

Dear Ms. Morris:

The Nasdaq Stock Market, Inc. ("NASDAQ") appreciates the opportunity to respond to the Concept Release of the Securities and Exchange Commission (the "Commission" or "SEC") regarding implementation of the provisions of the Sarbanes-Oxley Act ("SOX") pertaining to management reports on internal control over financial reporting and the need for additional guidance thereunder. NASDAQ's perspective on these issues is informed by its status both as the operator of a venue for companies to raise capital in the public markets and as an accelerated filer that has been subject to the internal control reporting provisions of SOX for the past three years.

SOX's central purpose of strengthening internal controls is unambiguously beneficial. Measured against the yardstick of achieving this purpose, SOX has succeeded by requiring management certifications, strengthening the structure of internal controls, and forcing auditors to refocus on financial statements. At the same time, however, the benefits of SOX have come at the price of placing the U.S. capital markets at a competitive disadvantage, due to costs associated with the level of documentation SOX requires, the due diligence underlying the required auditor attestation, and the overly broad scope of internal controls subject to the legislation's reporting requirements. Accordingly, our suggestions are directed at better leveraging the beneficial elements and making changes to lessen the cost of elements of SOX that generate fewer benefits.

In the absence of an appropriate balance between the benefits of SOX and the costs to achieve them, stockholders and consumers are effectively forced to over-pay for SOX compliance. Unless rectified, this imbalance will undoubtedly result in damage to American competitiveness through higher costs, lower profitability, and lower stock prices. We encourage the SEC and Public Company Accounting Oversight Board ("PCAOB") to follow through on their commitment, made in a press release on May 17, 2006, "to improve the implementation of [SOX] Section 404 so that it will work efficiently and effectively for companies and auditors of all sizes and types while still maintaining the important investor protections it provides." We believe the suggestions contained below are practical, actionable steps that can be taken to attain SOX's benefits at a reduced cost.

Our responses to certain of the Commission's specific requests are attached. Please contact me at (212) 401-8744 if you have any questions.

Very truly yours,

Brian O'Malley

Brian G. O'Malley
Senior Vice President
Internal Audit

BGO/as

1. *Would additional guidance to management on how to evaluate the effectiveness of a company's internal control over financial reporting be useful?*

   Additional guidance in broadly defined areas would assist auditors and management in setting standards of program practice. For example, guidance as to materiality thresholds would assist in excluding non-material matters from the scope of internal control programs and in determining the significance of gaps or deficiencies in control design or operation that later come to light.

   Management practices are currently driven by a need to respond to external auditor methodologies that are, by design, risk averse. There continues to be a race toward the most risk averse implementation without regard to cost. Specific management guidance could address concerns such as the nature of the tests to be performed (for example, whether inquiry is a valid form of management test), the ability to rely on monitoring and entity level controls, and the use of risk assessment to focus testing activities for a given year.

   Specifically with regard to risk assessment, it would be helpful to modify the time frame for management's testing of internal controls to span a longer period, such as a three-year cycle, based on a risk-assessment model. With this approach, higher risk processes/controls are tested annually, and lower risk processes/controls are tested on a rotating basis. A risk-based approach to testing would permit more time and emphasis to be placed on higher risk areas and internal control enhancements. While this model will require close coordination between auditors and their clients, we do not believe it would result in any notable incremental effort over the amount currently expended to coordinate management and external auditor testing.

   Providing additional guidelines, best practices, examples, and checklists in standard process areas, such as revenue, expenses, assets, liabilities, and capital, would also be helpful in assisting an organization to identify the most key controls over financial reporting. Currently companies are left to start with a blank canvass, yet the risks, assertions and control objectives are similar for these standard business processes.

2. *Are there special issues applicable to foreign private issuers that the Commission should consider in developing guidance to management on how to evaluate the effectiveness of a company's internal control over financial reporting?*

   In general, the application of SOX should recognize the additional complexities imposed on foreign private issuers, and these companies should be allowed sufficient time for compliance. SOX should be made to work for all issuers – domestic and foreign.

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

   The recent guidance from the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") is valuable because in addition to describing broad principles, it highlights practices that would satisfy those principles. Thus, it is desirable to have additional guidance using examples to describe an acceptable level of control, or even using case studies to highlight a combination of practices that constitute an acceptable control environment. In particular, examples may be used to illustrate materiality determinations and the merits of relying on monitoring controls.

4. *Are there additional topics, beyond what is addressed in this Concept Release, which the Commission should consider issuing guidance on?*

An appropriate independent entity, such as the Government Accountability Office ("GAO") or a committee of industry representatives, should conduct a study of companies to assess the effects of SOX on corporate behavior and the relative cost-effectiveness of each provision. The focus should be on emphasizing provisions that are cost effective and removing those that are not.

6. *What types of evaluation approaches have managements of accelerated filers found most effective and efficient in assessing internal control over financial reporting? What approaches have not worked, and why?*

We have found that the need to demonstrate across-the-board controls in the first year that a Section 404 certification must be made is very costly. Accordingly, we would suggest a phased-in approach for non-accelerated filers to allow a reasonable and cost-effective implementation. Thus, certifications in early years could focus successively on entity-wide, large dollar accounts; reserves/estimations; monitoring; and finally on more discrete activities for significant processes.

7. *Are there potential drawbacks to or other concerns about providing additional guidance that the Commission should consider?*

We do not believe there are any potential drawbacks to providing additional guidance. Guidance is clearly needed to align more closely the certification programs of the PCAOB, independent public accountants, and public companies.

8. *Why have the majority of companies who have completed an assessment, domestic and foreign, selected the COSO framework rather than one of the other frameworks available, such as the Turnbull Report?*

The COSO framework is the best understood model in the United States, and is consistent with Turnbull. The unnecessary costs associated with SOX are not the result of the choice of framework but rather the lack of actionable guidance that sets the bar based on risk within the nomenclature of the framework.

9. *Should the guidance incorporate the May 16, 2005 "Staff Statement on Management's Report on Internal Control over Financial Reporting"? Should any portions of the May 16, 2005 guidance be modified or eliminated?*

Additional guidance should be provided to mediate conflicting perspectives with a goal of establishing what is important to investors and listed companies. While the May 16, 2005 guidance describes the process and associated elements, it should be extended to help set the bar to describe acceptable level of risk. This could be accomplished by using type of account (e.g. balance sheet vs. revenue), value of account, volatility of account, control execution precision, and levels of proof. Following current materiality guidance, there is no difference between categorizing an error of $5 million against a $50 million revenue account and an error of $5 million against a $ 2 billion equity account, yet the risk to the investing community is much greater with the revenue account. Another option would be for the SEC to work directly with COSO to describe monitoring controls to which listed companies could aspire. There needs to be far more granularity in requirements for documentation, measurement and reporting based on what is important to the investors.

10. *We also seek input on the appropriate role of outside auditors in connection with the management assessment required by Section 404(a) of Sarbanes-Oxley, and on the manner in which outside auditors provide the attestation required by Section 404(b). Should possible alternatives to the current approach be considered, and if so, what?*

We believe that it would be beneficial to develop a recognition system whereby superior internal control environments are held up as examples for other public companies to follow. In addition, we believe that the Commission should allow a performance-based system for conducting external SOX audits, under which companies that have achieved an annual audit with no material weaknesses would be permitted to perform external SOX audits on a rotating basis.

While we agree that detailed internal control documentation is essential for all complex and high-volume transaction processes, we also believe that the Commission should encourage more widespread use of the integrated audit, under which substantive audit procedures supplemented with summary controls documentation suffices for certain non-complex and low-volume transaction processes. Additionally, the case can be made that with the renewed IPA focus on financial auditing, a monitoring only control proof could suffice.

We also believe that more detailed guidance should be provided to auditors to counter-balance the incentive for audit firms to interpret SOX conservatively. In many cases, SOX may encourage an excessive focus on auditors' opinion/litigation risk and attendant revenue considerations. A healthy counter-balance to this conservatism is required to prevent bloated audit regimes that may nevertheless be sub-optimally effective. The PCAOB, for example, needs to clarify and codify risks, definitions, and scope in both quantitative and qualitative terms.

11. *What guidance is needed to help management implement a "top-down, risk-based" approach to identifying risks to reliable financial reporting and related internal control?*

Guidance should describe risk from an investor's perspective and tailor the proof of control accordingly. There is little benefit provided by the all-encompassing, one-size-fits-all approach currently deployed. Focusing on the quality of risks articulated in the 10-K and associated controls could improve the process. Another helpful step would be tiering the proof and precision of control according to account value and type. Guidance should also be provided on which combination of top-down monitoring controls can take priority and should offer relief from including a multitude of discreet controls. Guidance must be sufficiently clear to enable the auditing community to rely on the results of management's risk assessment. Too often, auditors take a binary approach under which all risks within the scope of an audit are assigned equal importance. Guidance should make it clear that auditors may take a stratified approach under which the risk associated with an account may be differentiated based on its dollar value.

Providing additional guidelines, examples, and checklists in standard process areas, such as revenue, expenses, assets, liabilities, and capital, would also be helpful in assisting an organization to identify the most key controls over financial reporting.

12. *Does the existing guidance, which has been used by management of accelerated filers, provide sufficient information regarding the identification of controls that address the risks of material misstatement?*

    Current guidance does not clearly describe what actually needs to be tested. The testing program of many external auditors in today's environment is a function of efficiencies that they gain by coordinating testing with auditing for periodic disclosures. Thus, the testing program may not be sufficiently calibrated to the actual risk associated with particular accounts. We believe that a top-level monitoring control could cover much ground that is currently the subject of narrow, account-specific tests.

15. *What guidance is needed about the role of entity-level controls in evaluating and assessing the effectiveness of internal control over financial reporting? What specific entity-level control issues should be addressed? Should these issues be addressed differently for larger companies and smaller companies?*

    Guidance should be provided to explain the circumstances under which entity-level controls can serve as the primary control during testing, with operational controls being relied upon as mitigating controls. In far too many firms, controls at the operational or transaction level are being tested exclusively, with no reliance on entity-level controls. At larger firms, it may be appropriate to review some operational or transaction-based controls, but to a far lesser extent than is now the case.

16. *Should guidance be given about the appropriateness of and extent to which quantitative and qualitative factors, such as likelihood of an error, should be used when assessing risks and identifying controls for the entity?*

    Yes. To the extent that a process consists of high-value, high-risk transactions, it is obvious that more specific controls need to be documented. What has not been addressed is the converse: to what extent is it appropriate for assessments of high-volume, low-value, and low-risk transactions to rely solely on entity-level or management-monitoring controls? Additionally, if a control has been successfully proven to work, it should be tested less frequently.

17. *Should the Commission provide management with guidance about fraud controls?*

Common financial reporting and operational control guidelines and examples would be useful and facilitate common understanding of these risks. Guidance should address the nature of fraud that is within the scope of SOX compliance, possibly distinguishing management fraud from employee or operational fraud, and should address the risk assertion pertaining to safeguarding of assets. The SEC may be able to provide a forum for sharing best practices. Specific examples of the types of fraud risks that would fall under the scope of SOX testing would be useful in deciding what operational controls could be relied upon.

18. *Should guidance be issued to help companies with multiple locations or business units to understand how those affect their risk assessment and control identification activities?*

For organizations with multiple business units, guidelines for developing representative sample testing sizes that would be representative of a cross section of those business units would be helpful. Currently, there are differing standards that would bring foreign locations into scope.

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

The Commission and the PCAOB should revisit guidance surrounding key definitions relied upon in Section 404 compliance, including "significant deficiency" and "material weakness." Currently, the definitions are derived from traditional financial reporting GAAP guidance. Instead, the focus should be on measuring problems that would have a material effect on an investor's investment decision. For example, a "material weakness" could be defined as, among other things, an event that would diminish gross revenue by a specified percentage. The Commission and the PCAOB should set different thresholds based on the type of account (e.g., P&L, equity, asset), and may allow different options in measuring impact (e.g., percent effect on market capitalization or revenue).

In addition, further guidance on testing procedures (sample sizes, etc.) to remediate a material weakness or significant deficiency would prove beneficial in terms of streamlined testing and improving communication between auditors and management.

28. *How have companies been able to use technology to gain efficiency in evaluating the effectiveness of internal controls?*

The existing accounting technology at many companies can provide innovative methods for demonstrating accuracy and completeness by using these systems for uses other than their originally intended functions. For example, technology for tracking inventory trends could be used to validate revenue.

29. Is guidance needed to help companies determine which IT general controls should be tested? How are companies determining which IT general controls could impact IT application controls directly related to the preparation of financial statements?

Guidance is required to identify the portions of IT frameworks that are specifically applicable to SOX. In the absence of such guidance, the conservative approach taken by many auditors causes the entire framework to be incorporated into SOX compliance efforts. The identification of specific SOX components will allow the appropriate allocation of funds to aspects subject to annual testing and those subject to cyclical testing.

The Control Objectives for Information and Related Technology ("COBIT") framework has been used as the general controls guideline but its scope is too broad. Again, guidelines should identify the most important aspects of IT programs – such as Program Development, Program Changes, Computer Operations, and Access to Programs and Data – and these aspects should then be audited with recognition of the degree of impact on financial statements.

31. Were the levels of documentation performed by management in the initial years of completing the assessment beyond what was needed to identify controls for testing?

During the first year of compliance, auditors typically required every activity within a process to be documented, regardless of the materiality or criticality of that activity. The costs associated with maintaining this high level of detail in legacy documentation can be greatly reduced through clarification of the level of detail required for process documentation.

32. 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?

Standard documentation should initially include flow charts and narratives. However, small changes to processes require small effort to update narratives but relatively larger efforts to update flowcharts. It would be helpful if guidance were provided advising when additional updates were not necessary to all documentation. For example, flowcharts may no longer be necessary for mature processes, or flowcharts may be required to be updated more frequently for high-risk areas and less frequently for low-risk areas.