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

Re: File No. S7-11-06

Dear Ms. Morris:

Hess Corporation (the Corporation), a large accelerated filer operating in the oil and gas industry, appreciates the opportunity to comment on the Concept Release Concerning Management's Reports on Internal Control over Financial Reporting. Since the cost of complying with Section 404 of the Sarbanes-Oxley Act has been significant, the following comments were prepared to express the Corporation's views on areas where additional guidance could lead to cost reduction, without significantly increasing internal control risk. The responses are keyed to the question numbers in the Concept Release.

<u>Question 10 – The role of outside auditors</u>

We believe the Staff should re-evaluate whether two separate audits of internal control over financial reporting should be required under Section 404. In an audit of management's assessment, the outside auditors are required to perform sufficient testing and review of management's evaluation of internal control over financial reporting to render an opinion that management's assessment is fairly stated. However, to achieve the principal evidence threshold in an audit of the registrant's internal control over financial reporting, the outside auditor must perform substantial incremental work beyond that required in an audit of management's assessment. For example, outside auditor re-tests of controls tested by management as part of management's assessment do not qualify as principal evidence. In addition, the outside auditor performs other testing simply to achieve the principal evidence threshold that may not be necessary to render an opinion on management's assessment.

The necessity to perform this incremental work is driven by Auditing Standard No. 2, *An Audit of Internal Control over Financial Reporting Performed in Conjunction with an Audit of Financial Statements* (AS No. 2). AS No. 2, paragraph 27 states…"In an audit of internal control over financial reporting, the auditor must obtain sufficient competent evidence about the design and operating effectiveness of controls over <u>all</u> relevant financial statement assertions related to <u>all</u> significant accounts and disclosures in the financial statements." Paragraph 108 states, "In all audits of internal control over financial reporting, the auditor must perform enough of the testing himself or herself so that the auditor's own work provides the principal evidence for the auditor's opinion." Furthermore, the response to Question 21 of the Questions and

Answers on AS No. 2, states…"the auditor's testing of the work of others is not considered part of the principal evidence obtained by the auditor." This guidance has resulted in duplication of effort and increased cost.

We believe that eliminating the outside auditor requirement to perform an independent audit of the registrant's internal control over financial reporting would not significantly lessen the effectiveness of Sarbanes-Oxley Section 404. Leveraging the integrated audit approach by allowing the outside auditor greater flexibility to consider the results of substantive testing in the financial statement audit coupled with the results of internal control testing on the audit of management's assessment could generate significant cost savings while still achieving the ultimate goal for the investing public – reliable financial reporting. As such, we recommend that Section 404 and AS No. 2 be amended to solely require outside auditors to audit management's assessment of internal control over financial reporting.

If the Staff does not agree with this recommendation, we believe at a minimum, any retesting of controls by the outside auditor included in management's assessment should qualify in the determination of principal evidence. In addition, the external auditor should be permitted to place greater reliance on management's testing based on the judgment of the auditor after considering risk, cumulative historical results of internal control testing, lack of changes in controls, qualifications of individuals performing tests, etc.

<u>Questions 15 and 19 – Entity level controls</u>

Most large corporations have substantial GAAP expertise, and active internal disclosure review committees and external audit committees. In addition, most large corporations spend significant effort to prepare budgets and forecasts for a number of reasons, including use as a control to compare against actual results. In our opinion, the current approach to Section 404 compliance does not fully leverage these and other entity level controls because the ability to evaluate the effectiveness of entity level controls to mitigate potential weaknesses in lower level transactional controls is subjective and difficult to correlate. This issue, combined with the desire for outside auditors to be able to quantify scope coverage of a financial statement line item, drives behavior toward testing transactional controls. As a result, significant effort is put forth toward testing low-level account and transactional controls, even though there is a low risk that a deficiency in these controls could have a material effect on the financial statements. Many of the major financial reporting abuses that the Sarbanes-Oxley Act was designed to correct occurred in the entity level controls, not the transactional level.

Therefore, internal control assessments by management and the external auditor should place a greater emphasis on entity level controls and move away from focusing on achieving substantial financial statement line item scope coverage underpinned by testing of low level transaction controls. Having tested transactional controls for three consecutive years, management should have the ability to shift its focus to monitoring and evaluating <u>changes in the control environment</u>, rather than repeatedly performing detail tests. Such an approach would allow the concept of rotational testing to be a component of management's assessment. For example, if cumulative test results of a routine process have been satisfactory and entity level and monitoring controls (including quarterly Section 302 updates) indicate that a process has not changed, the process may be a candidate for rotational testing whereby a walkthrough or very limited testing may be sufficient to support management's assessment of the process in any off-cycle year.

Specific guidance should be provided by the Staff to help registrants and outside auditors understand how effective entity level controls coupled with an appropriate top-down risk assessment can displace testing of low level transactional controls, as well as provide the platform for a rotational testing plan. To the extent required, AS No. 2 should be amended to be consistent with any new guidance issued by the Staff.

Question 22 – Separate evaluation-type testing versus ongoing monitoring activities

Current guidance in paragraph 104 of AS No. 2 on the extent of tests of controls states…"Each year the auditor must obtain sufficient evidence about whether the company's internal control over financial reporting, including the controls for all internal control components, is operating effectively. This means that each year the auditor must obtain evidence about the effectiveness of controls for all relevant assertions related to all significant accounts and disclosures in the financial statements…." In a stable internal control environment, coupled with an appropriate risk assessment and ongoing monitoring activities, we believe that rotational testing should be permitted, such that not every internal control needs to be tested each year. For example, rotational testing of lower level transactional controls should be permitted over a 2 or 3 year period. Similarly, in an IT environment with adequate security and effective access and change controls, detail testing of application controls over accounts and reports should not be required on an annual basis. Application controls should require annual testing only when IT general controls cannot be relied upon to prevent a change in the application controls.

Registrants and outside auditors would benefit from guidance on when it would be appropriate to rotate tests of internal controls over a period greater than one year.

Question 23 – Timing of management testing

In a company with effective internal control over financial reporting, the company should have the option to spread the work evenly over the year to avoid peak workloads. The guidance in AS No. 2 has led to inefficiencies in resource utilization and increased costs of compliance because of the requirement that testing be performed in the second half of the year. This practice resulted from guidance in AS No. 2 such as paragraph 98 which states…"The auditor must perform tests of controls over a period of time that is adequate to determine whether, as of the date specified in management's report, the controls necessary for achieving the objectives of the control criteria are operating effectively." In addition, Question 51 of the May 16, 2005 Questions and Answers, provides specific examples of roll-forward procedures to the "as of" date, generally year-end.

Based on an assessment of risk, cumulative results of internal control testing, and an effective control environment, management should have the ability to select test samples throughout the year without regard to the "as of" date in order to reduce the "peak load" that occurs under current regulations. Under this proposal, controls of a lower risk may be tested in the beginning of the year while controls with greater risk would be tested later in the year. In addition, we believe that roll-forward procedures to year-end are unnecessary when no weaknesses were identified during testing and monitoring controls indicate that there have been no changes in the control or the control environment.

Registrants would benefit from guidance on how management and the outside auditor can make the assertion that internal controls tested earlier in the year continue to be effective through year-end based on the absence of any significant changes in the control or the control environment. To the extent required, AS No. 2 should be amended to be consistent with any new guidance issued by the Staff.

## Summary

We appreciate the opportunity to provide feedback to the Staff on the questions raised in the Concepts Release. The Staff has significant flexibility in the guidance it may choose to issue to potentially reduce the cost of compliance with Section 404 without diminishing the effectiveness of the statute. We believe that our recommendations can be implemented in the aggregate and still provide appropriate and adequate assurance of reliable financial reporting for the investing public. We request you give serious consideration to the following recommendations and provide additional guidance where appropriate:

- ✓ Eliminate the separate audit of internal control over financial reporting by the external auditor;
- ✓ Allow management to place increased reliance on entity level controls to reduce transactional testing;
- ✓ Permit rotational testing of internal controls; and,
- ✓ Increase flexibility of timing of management testing to reduce or eliminate "peak" workload periods.

We would be pleased to provide any additional information.

Sincerely yours,

John P. Rielly
Senior Vice President and
Chief Financial Officer