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February 26, 2007

Ms. Nancy Morris
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington DC 20549-9303

RE: File Number S7-24-06, *Management's Report on Internal Control over Financial Reporting*

Dear Ms. Morris:

PricewaterhouseCoopers appreciates the opportunity to provide our perspectives on the Securities and Exchange Commission's ("SEC") proposed interpretation and proposed rule, *Management's Report on Internal Control over Financial Reporting* ("management's guidance"). We support the SEC's efforts to improve the effectiveness and efficiency of Section 404 of the Sarbanes-Oxley Act of 2002 ("Section 404") by providing management-specific guidance. We believe such guidance will facilitate management's assessment of internal control over financial reporting and eliminate the need to comply with guidance originally intended for an external audit.

The principles of Section 404 have contributed to improving financial reporting in the capital markets by helping to restore investor confidence and by increasing the transparency and reliability of financial information reported to investors. In addition, the principles of Section 404 have contributed to operational and regulatory compliance improvements. We believe that it is important for management's guidance to preserve the significant progress companies have made in reporting accurate and transparent information to the capital markets. The primary benefit of Section 404 is the protection it affords investors. We believe that, if implemented appropriately, the principles in management's guidance will preserve investor protection while improving the efficiency of implementation of Section 404. Efficiencies will largely be achieved by (1) applying a top-down, risk-based approach to identify which controls to assess and (2) leveraging the opportunities available to management to obtain evidence of the effectiveness of internal control over financial reporting.

We believe improving the correlation between the level of effort and the level of risk will help balance the costs and benefits associated with Section 404 compliance. We believe management's guidance, when combined with the Public Company Accounting Oversight Board's ("PCAOB") proposed auditing standard, will contribute to increased efficiency and a reduction in the total costs of compliance with Section 404. The degree of benefit will vary significantly from company to company and will depend on many factors, including the extent to which a top-down, risk-based approach was previously implemented.

Key Principles

We support the following principles, which we believe are fundamental to both an effective and efficient assessment of internal control over financial reporting:

- *Principles-based guidance.* The principles outlined in the proposed guidance afford management considerable flexibility to scale and tailor its annual evaluation of internal control over financial reporting to a company's specific facts and circumstances, which will enable management to conduct the most effective and efficient evaluation practicable. Principles-based guidance provides greater opportunity for the application of appropriate and well-reasoned judgment. The increased use of judgment and focus on risk will encourage management to perform a robust and comprehensive assessment of the risks of a material misstatement of the financial statements, which will have a pervasive impact on the effectiveness of management's assessment of internal control over financial reporting.

  The value of principles-based guidance is that it encourages appropriate application to individual facts and circumstances. In order for principles-based guidance to be most effective, well-reasoned judgment, which may result in a range of acceptable alternatives, must be accepted by various parties, including regulators.

- *Top-down, risk-based approach.* The assessment of risk underscores the entire evaluation process. The SEC's emphasis on applying a top-down, risk-based approach encourages management to align its evaluation process with its assessment of risk. Furthermore, the guidance allows management to focus only on those controls that are needed to adequately address the risk of material misstatement in the financial statements.

- *Evidence of operating effectiveness.* An important principle of the proposed guidance is that management must evaluate evidence about the operation of internal control over financial reporting. We agree that annual testing of the operating effectiveness of internal control over financial reporting is critical to preserving the value that Section 404 has created for investors.

  As proposed, management's guidance provides high-level guidance regarding the necessary work to be performed in subsequent annual assessments. We believe that the nature of the guidance may be subject to misinterpretation, or in other words, we believe that companies may infer that merely performing a change-based evaluation is sufficient. While we believe that it is appropriate for management to consider results of past assessments, we believe that it should be made clear that the evaluation of operating effectiveness is an annual requirement.

- *Consideration of fraud.* Effective internal control over financial reporting can be a deterrent to fraudulent financial reporting. We believe that it is important for the SEC to reinforce management's responsibility to evaluate internal controls designed to prevent or detect material misstatements due to error or fraud.

Importance of Coordination with the Independent Auditor

The most efficient Section 404 process results from a coordinated approach between management's assessment and the independent auditor's audit of internal control over financial reporting. Failure to appropriately acknowledge the interaction of the two processes may frustrate and hinder efforts to improve the collective efficiency. It is essential that management understand that the decisions it makes regarding how to conduct its assessment of internal control over financial reporting may significantly impact the efficiency of the audit. Specifically, the quality of management's assessment process (e.g., quality of documentation, nature and extent of testing) will impact the extent of the auditor's ability to rely on the work of others.

We recommend that the SEC include a discussion of the interdependency of the respective approaches in the final guidance given the pervasive impact of the relationship between management's assessment and the audit of internal control over financial reporting.

Alignment of Management's Guidance and the Proposed Auditing Standard

Implicit in the aforementioned relationship between management's assessment and the auditor's audit of internal control over financial reporting is the importance of aligning certain principles embedded in both the guidance for management and the auditing standard.

While we acknowledge and agree that management appropriately has significant latitude in assessing internal control over financial reporting and has available to it sources of evidence that are not available to the auditor, we have provided three examples of principles that, if more closely aligned and clarified, will contribute to more efficient compliance with the provisions of Section 404:

- *Entity-level controls.* We believe it is important to clarify the description and range of impact of entity-level controls and ensure it is aligned with the corresponding description in the PCAOB's auditing standard. Toward that end, we believe it would be useful to include in the guidance a principles-based continuum for considering the impact of entity-level controls on the nature, timing and extent of management's evaluation of controls at the process, transaction or application levels. The continuum should consider whether a company-level control is directly or indirectly related to a relevant assertion for a significant account as well as the precision at which the entity-level control operates. We believe that the concept of a continuum best describes the relationship between the consideration of the precision of entity-level controls and the extent of testing, if any, necessary for lower-level controls.

We envision the continuum to extend between (1) a direct entity-level control that is designed to operate at a degree of precision that would, by itself, prevent or detect on a timely basis material misstatements to one or more relevant assertions, and (2) an indirect entity-level control (e.g., the control environment) that is not directly related to any relevant assertion for any specific significant account and, therefore, would not by itself prevent or detect on a timely basis material misstatements to one or more relevant assertions. In our experience, indirect controls are significantly more prevalent than direct entity-level controls.

The guidance should acknowledge that it would be sufficient to only test an entity-level control when the entity-level control operates effectively at a degree of precision that would, by itself, prevent or detect on a timely basis material misstatements to one or more relevant assertions. When the direct entity-level control does not operate at that appropriate degree of precision, it would be necessary for the auditor to test process, transaction or application level controls. The guidance should acknowledge that the consideration of controls that are not at the appropriate level of precision (i.e., indirect entity-level controls) factors into the determination of the nature and extent of testing. Examples may be an effective way to illustrate these important concepts.

- *Key terminology.* The usage of common key terminology by management and the auditor ensures clarity and a mutual understanding in areas where management's guidance and the auditing standard should be aligned. We believe, for example, that the reference to "financial reporting elements" in the SEC guidance compared to the use of the term "significant accounts and disclosures" or "relevant assertions" in the PCAOB standard may create unnecessary confusion and inefficiencies.
- *Strong indicators of a material weakness.* We concur with the SEC regarding the importance of identifying strong indicators of a material weakness. However, we believe that in this area, it is important that the strong indicators be the same for both management and the auditor. Alignment of the strong indicators of a material weakness in management's guidance and the auditing standard will minimize the risk that management and the auditor arrive at different conclusions regarding the effectiveness of internal control over financial reporting.

Conclusion

Minimizing the disruption from implementation of management's guidance is important to all constituents. Toward that end, we encourage the SEC's expedient consideration of these proposals and others received in the comment period to allow for the release of the guidance as soon in 2007 as possible. A timely release of management's guidance will allow for maximum efficiency to be achieved for years ending in 2007, when practical.

In summary, we support the SEC's efforts to improve the effectiveness and efficiency of Section 404. We appreciate the coordinated efforts of the SEC and the PCAOB including the concurrent comment periods. We also appreciate that management's guidance and the

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proposed auditing standard retain the quality, transparency and reliability of financial reporting that compliance with Section 404 has brought to the capital markets.

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We would be pleased to discuss our perspectives and to answer any questions that the SEC staff or the Commission may have. Please do not hesitate to contact Vincent Colman (973-236-5390) or Jim Lee (973-236-4478) regarding our submission.

Sincerely,

PricewaterhouseCoopers LLP