NATIONAL ASSOCIATION OF
REAL ESTATE INVESTMENT TRUSTS®

February 26, 2007

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

RE: Release No. 33-8762; File No. S7-24-06: Proposed Rule – Management's Report on Internal Control Over Financial Reporting

Dear Ms. Morris:

The National Association of Real Estate Investment Trusts® (NAREIT) welcomes this opportunity to respond to the request for comments from the Securities and Exchange Commission (SEC or Commission) on the concepts and questions contained in Release No. 33-8762; File No. S7-24-06: Proposed Rule – Management's Report on Internal Control Over Financial Reporting (proposed rule).

NAREIT is the representative voice for U.S. real estate investment trusts (REITs) and publicly traded real estate companies worldwide. Members are REITs and other businesses that develop, own, operate and finance income-producing real estate, as well as those firms and individuals who advise study and service those businesses. We are proud to report that the real estate/REIT industry has been consistently ranked in the top three of 24 industry groups for corporate governance according to the Corporate Governance Quotient rankings published by Institutional Shareholder Services.

This letter offers certain general and specific comments in response to the proposed rule. NAREIT has previously participated in, and been very supportive of, efforts to provide additional guidance to reduce the burden of compliance while maintaining effective controls over financial reporting.

NAREIT strongly supports the need for effective internal controls over financial reporting. We believe that, on balance, the proposed rule would continue to improve the effectiveness of public company financial reporting.

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Comments

The proposed rule represents a positive step so that management would no longer have to rely on internal control guidance from the Public Company Accounting Oversight Board (PCAOB) aimed at auditors, while continuing to hold management responsible for their internal controls. Providing principles-based guidance is a very sound and flexible approach that would allow competent management teams to form effective evaluation processes without being bound by trying to apply very detailed rules. Additionally, this rule explicitly recognizes and validates management's use of judgment and risk assessments in the evaluation of internal controls.

The following are specific comments that NAREIT requests that the Commission consider:

- Many of NAREIT's member companies use a standard testing methodology that incorporates risk as well as volume when determining sample size. It would be helpful if the Commission would provide a methodology for determining sample size similar to the example below.

Annual Sample Sizes for Manual Controls

	Low Risk	Medium Risk	High Risk
Annual control	1	1	1
Quarterly control	1	2	4
Monthly control	4	5	6
Weekly control	10	15	20
Once daily control	20	30	40
Multiple times daily control	30	45	60

Additionally, it would be helpful if general practices related to sampling techniques were either validated or discredited by the Commission. Examples of widely used practices used include the practice of:
- retesting when one sample out of the population fails
- retesting an entirely new population sample size to determine whether the control has failed
- failing the effectiveness of the control when both populations fail

- It would be helpful if the Commission would provide more specific guidance relating to entity level controls and the overall control environment. Specifically, the methods of assessing and testing entity level controls vary widely and management teams generally find it difficult to quantify 'tone at the top' controls. Although there is a widely held belief that the Commission of Sponsoring Organizations of the Treadway Commission ("COSO") provides excellent general guidance, a consensus exists that an illustrative questionnaire or checklist of controls is needed to provide management assurance that complete work around this area is being performed and address inconsistencies between various audit practices.

- It would be helpful if the Commission would provide additional explanation on the role and importance of information technology (IT) general controls as they relate to internal controls over financial reporting. Also helpful would be additional guidance that explains the relationships or dependencies between IT general controls and application controls, particularly in smaller companies, including examples of when an IT general control deficiency could result in an application control breakdown, in turn leading to a material misstatement. Some guidance or examples of the relationships between application controls in prepackaged software and IT general controls necessary to support them also would be helpful.

- We suggest that the SEC establish some conservative “safe harbor” quantitative thresholds to serve as examples in providing guidance to assist management in determining whether certain controls could have a material impact on the financial statements. For example, if a breakdown in a specific control, taking into consideration potential skews in performance measures from one-time events, is estimated to have an impact of less than:

  - 2.5% of Revenues,
  - 2.0% of Operating Income,
  - 1.5% of Income before Income Taxes, or
  - 1.0% of Total Assets
  - 1 cent of EPS

  and would not:

  - Change net earnings to net loss or vice versa,
  - Affect the company’s compliance with regulatory requirements, or
  - Affect the company’s compliance with debt covenants or other contractual arrangements,

  then such control would be deemed to be immaterial.

- We encourage the SEC to establish a resource that would provide on-going guidance to assist companies in complying with the requirements of the Sarbanes-Oxley Act and with the SEC’s proposed rule.

- Some companies have been reluctant to consult with their auditors and other advisors about internal controls due to fear that such a conversation might be construed as evidence that a material weakness exists. We encourage the SEC and PCAOB to further clarify that it is acceptable for management to consult with auditors and others without fear of retribution and to encourage management and their auditors to be able to have an open dialogue on all matters including seeking advice that will assist in maintaining sound internal controls.

- Many companies, including the early adopters, have already completed their assessments of internal controls over financial reporting and their assessments have been successfully audited as part complying with the Section 404 requirements. While some interpret the

SEC's proposed rule as requiring a complete re-work of their risk assessment and control mapping exercises, others see it as a "relaxing of the rules." We request that the SEC work with the PCAOB and both explicitly state that changes a company makes as part of adopting the SEC's proposed rule should not be interpreted as a derogation or weakening of controls that could jeopardize management's or the auditor's assessment of internal controls over financial reporting.

- While we believe that the SEC's proposed rule, along with the proposed new auditing standard from the PCOAB, *An Audit of Internal Control Over Financial Reporting that is Integrated with an Audit of Financial Statements*, represent significant steps in the right direction, we believe that the anticipated increase in audit efficiencies and reductions in work effort and cost from adopting the proposed rule and auditing standard would not be achieved so long as the PCAOB's evaluation of audit firms continues to take a detailed compliance-based approach to enforcing the standards. The audit firms will implement the new auditing standard based on how they feel they are evaluated by the PCAOB regardless of the SEC's guidance to management.

  We urge the SEC and PCAOB to take the lead with respect to adopting the spirit and philosophy of the proposed standard especially as it affects PCAOB inspections of audit firms. To this end, we recommend that the SEC and PCAOB issue a statement to the auditing profession describing the steps they will take to ensure that the evaluation of audit performance will be consistent with the top-down, risk based approach discussed in the proposed rule and audit standard. Only with this change to the PCAOB inspections can we hope to see any increase in efficiencies and reduction in audit fees.

Conclusion

NAREIT strongly supports the need for effective internal controls over financial reporting. We believe that, on balance, the proposed rule would continue to improve the effectiveness and efficiency of public company financial reporting. We look forward to further guidance from the SEC, and will continue to participate in the positive evolution of corporate practices that promote ethical and effective financial reporting.

Respectfully submitted,

George L. Yungmann
Senior Vice President, Financial Standards