EALIC

European Association of Listed Companies AISBL-IVZW

SECURITIES AND EXCHANGE COMMISSION
To Ms. Nancy M. Morris, Secretary
100 F Street
Washington, D.C. 20549
USA

BY ELECTRONIC MAIL

Brussels, 8 March 2007

Re: Proposed Interpretive Guidance for Management Reports on Internal Control over Financial Reporting, SEC File No. S7-24-06

Dear Ms. Morris,

EALIC is submitting this letter in response to the request of the Securities and Exchange Commission (the "Commission") for comment on the Commission's proposed interpretive guidance for management regarding its evaluation of internal control over financial reporting ("ICFR"). The proposed amendments are discussed in Release Nos. 33-8762; 34-54976; File No. S7-24-06 (the "Release").

We strongly support the parallel efforts of the Commission and the Public Company Accounting Oversight Board (the "PCAOB") to better balance the benefits of reporting on and auditing ICFR against the cost and complexity of the process. In particular, we welcome the decision to eliminate the need for a company's auditor to separately pass upon the adequacy of management's evaluation of ICFR. Taken together with the separate guidance the Commission has proposed for management, we believe these efforts send a strong message – that management's assessment stands on its own and **is** no less important than the assessment by the company's auditor – and that the company's auditor is not the sole arbiter of the scope of procedures and testing needed to properly evaluate the Company's ICFR. If properly implemented, we believe these provisions will help put management on a more equal footing with their auditors on ICFR issues and promote a more useful dialogue between companies and their auditors regarding ways to make internal control audits more cost-effective.

We also support the proposal to include language in Rules 13a-15 and 15d-15 to confirm that an evaluation that complies with the interpretive guidance will satisfy the evaluation requirement in the rules. We believe that this language will provide more certainty to management and strengthen the position of management when discussing ICFR matters with the company's auditors.

The Commission's efforts are an important step in the direction of making the process of reporting on internal control over financial reporting less complex and more cost-effective. We believe, however, that these objectives can only be fully realized if companies are able to effectively implement a top-down, risk-based approach. We suggest below several changes we believe would enhance the proposal.

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1. The Commission should revise the definition of "financial reporting risks" to exclude risks that fall beneath the "reasonably possible" threshold.

Under the approach outlined in the interpretive guidance, the first step in evaluating internal control over financial reporting is to identify financial reporting risks. Once those risks are identified, management proceeds to evaluate whether it has controls that adequately address those risks and selectively tests controls to determine their operating effectiveness.

Although the definition of "material weakness" makes clear that the applicable probability threshold for reporting purposes is a "reasonable possibility" of a material misstatement, the definition of "financial reporting risks" by its terms extends to all risks that "could" result in a material misstatement. We believe this discrepancy could lead management to unnecessarily focus on identifying and evaluating the existence of controls to address risks that fall below the reporting threshold. This would increase the cost and complexity of the evaluation process without providing meaningful benefits to investors. If a risk falls below the reporting threshold, management should not be required to implement or evaluate controls to address it.

To address this concern, we suggest that the Commission revise the definition as follows:

"Management uses its knowledge and understanding of the business, its organization, operations and processes to consider the sources and potential likelihood of misstatements in financial reporting elements. Management identifies as "financial reporting risks" those risks that have a reasonable possibility of resulting in a material misstatement of the financial statements."

2. The Commission should clarify that risk assessment is relevant not only to the selection of controls for testing but also to their design.

We welcome the Commission's helpful guidance regarding the role of risk assessment in determining the scope of testing. We believe, however, that risk assessment is equally relevant to the design of controls, and that the Commission should expressly acknowledge that management's risk assessment should guide decisions regarding the nature, frequency and scope of the controls implemented to address a company's financial reporting risks.

3. The Commission should clarify that controls to address low-risk areas can be designed to operate and tested on less than an annual basis.

We welcome the Commission's endorsement of self-assessments and ongoing monitoring as potential sources of evidence of the operating effectiveness of internal controls. We share the Commission's view that evidence concerning the operation of controls involving low ICFR risk often can be effectively gathered exclusively using self-assessments and ongoing monitoring, without requiring separate direct testing.

Although the Commission's acknowledgement of the importance of self-assessments and ongoing monitoring are a step in the right direction, we believe that the risk-based testing approach outlined in the Commission's proposed guidance could be further enhanced by

clarifying that low-risk controls can be tested on less than an annual basis. We suggest that the Commission add language to the interpretive guidance to address this point.

Similarly, for lower-level financial reporting risks, we believe a control that operates on a rotation basis can be adequately designed to address a financial reporting risk even if it operates on less than an annual basis. Clarifying that controls need not necessarily be designed to operate every fiscal year in order to be effective will assist companies in reducing costs when implementing their controls. We suggest the Commission add language to the interpretive guidance to address this point.

4. The Proposed Guidance should expressly acknowledge that management can take strong entity-level controls into account in designing and testing controls relevant to individual areas.

We welcome the Commission's guidance on the importance of entity-level controls. We agree with the Commission that entity-level controls designed to operate at the process, transaction or application level often can adequately prevent or detect misstatements on a timely basis.

To further enhance the discussion of entity-level controls, we suggest that the Commission include language to acknowledge that strong entity-level controls also may be relevant to the nature of other controls that are put in place. In particular, where a company has strong entity-level controls, a company may be able to prevent and detect misstatements on a timely basis using fewer controls relevant to individual areas than otherwise would have been necessary.

5. The Commission should state clearly that the changes to Rule 2-02(f) of Regulation S-X are not intended to increase the auditors' role.

As noted above, we strongly support the decision of the Commission and the PCAOB to eliminate the requirement that the auditor pass separately upon management's evaluation. We also support the proposal to change Rule 2-02(f) of Regulation S-X to clarify the auditor's role. To ensure that the new language is not misinterpreted, however, we recommend that the Commission state clearly that the new language is not intended to expand the role of the auditors beyond that currently in place today.

6. ***The Commission should state clearly that the U.S. GAAP reconciliation is beyond the scope of ICFR evaluation and reporting***

We agree with the guidance in footnote 47 of the Release that management's evaluation process should focus on the primary financial statements. The U.S. GAAP reconciliation already imposes a heavy burden on foreign private issuers and provides a significant disincentive to accessing the U.S. capital markets. Requiring the U.S. GAAP reconciliation to be included in the ICFR assessment process would further compound this burden and impose additional costs on foreign private issuers that would not be justified by the marginal benefits achieved for investors, particularly in light of the considerable protection already afforded by the inclusion of the U.S. GAAP reconciliation footnote in the audit of the primary financial statements.

In light of the above concerns, we urge the Commission to state clearly that the U.S. GAAP reconciliation falls outside the scope of the ICFR reporting process. In particular, we recommend that the Commission revise footnote 73 of the Release to eliminate the requirement that management consider the impact of a control deficiency on the U.S. GAAP reconciliation when evaluating the deficiency's severity.

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We appreciate this opportunity to provide you with our thoughts on the proposed interpretive guidance. Please do not hesitate to contact our organization if you have any questions or need any additional information.

Very truly yours,

Dorien FRANSENS
Secretary General

cc: <u>Securities and Exchange Commission</u>
Hon. Christopher Cox, Chairman
Hon. Paul S. Atkins, Commissioner
Hon. Roel C. Campos, Commissioner
Hon. Annette L. Nazareth, Commissioner
Hon. Kathleen L. Casey, Commissioner

Securities and Exchange Commission – Division of Corporation Finance
Mr. John W. White
Ms. Carol A. Stacey

Securities and Exchange Commission – Office of Chief Accountant
Mr. Conrad Hewitt

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