

# ABA

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July 20, 2007

**via e-mail to:rule-comments@sec.gov**

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

**Re: File No. S7-24-06  
Definition of a Significant Deficiency**

Ladies and Gentlemen:

This letter is submitted on behalf of the Committees on Federal Regulation of Securities and Law and Accounting (the "Committees") of the Section of Business Law of the American Bar Association in response to the request for comments by the Securities and Exchange Commission (the "Commission") in its June 20, 2007 release relating to the matter referenced above.

The comments expressed in this letter represent the views of the Committees only and have not been approved by the American Bar Association's House of Delegates or Board of Governors and therefore do not represent the official position of the American Bar Association (the "ABA"). In addition, this letter does not represent the official position of the ABA Section of Business Law, nor does it necessarily reflect the views of all members of the Committees.

The Commission proposes to amend Exchange Act Rule 12b-2 and Rule 1-02 of Regulation S-X to define the term "significant deficiency" for purposes of the Commission's rules under Sections 302 and 404 of the Sarbanes-Oxley Act. The term would be defined as "a deficiency, or a combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those responsible for oversight of a registrant's financial reporting." The Commission's proposed

definition mirrors that adopted by the Public Company Accounting Oversight Board (“PCAOB”) in Auditing Standard 5.<sup>1</sup>

We support this proposal. We believe the proposed definition is appropriately tailored for its principal function—to provide a standard for determining deficiencies that management is required to disclose to the auditor and the audit committee. We think the use of the operative term “important enough to merit attention” appropriately allows management to exercise its best judgment as to what should be disclosed to the auditors and the audit committee. It also reflects the reality of the judgment that management will in fact make when it evaluates a deficiency; management is more likely to think of the issue in terms of what deficiencies are important enough to report to the auditors and audit committee than it is to think in terms of a measure of probability. Thus, we concur that including a “likelihood” component (or other criteria) would be unlikely to help the analysis. Nor is such a probability analysis particularly useful when the objective is to ensure that the oversight persons are properly informed about matters relevant to their oversight and there are no public disclosure implications. Management will not need to make fine distinctions about the probability of an outcome in that circumstance.

We also believe that it is important that management use the same definition of significant deficiency in determining what it must report to the audit committee and the auditors as the definition that the auditors use in complying with the requirement in Auditing Standard 5 that they report to the audit committee significant deficiencies that have been identified during the audit. In our opinion, this alignment between the Commission’s and the PCAOB’s approaches to Section 404 will also facilitate and enhance compliance with the reporting obligations.

The Commission’s release asks whether the proposed definition would result in less comparability among companies in terms of what management determines is a significant deficiency. While we doubt that the proposed definition would result in many differences in the nature of deficiencies that management reports to audit committees and auditors, we do not think that comparability or lack thereof is very relevant in this context. The key point is that management is able to certify that it has exercised its responsibility to advise the audit committee and the auditors about significant deficiencies, not that every management reaches the same conclusion as to what to report to the audit committee and the auditors.

We do not think that the definition will impose any additional costs and burdens on management in evaluating whether deficiencies meet the definition. Nor do we think it raises special issues for smaller companies.

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<sup>1</sup> We note one minor difference. The PCAOB’s definition has the word “the” before the last three words of the definition so that it reads “the company’s financial reporting” rather than, as stated in the Commission’s proposal, “a registrant’s financial reporting.” We recommend conforming the Commission’s definition to that in Auditing Standard 5.

Ms. Nancy M. Morris, Secretary

July 20, 2007

Page 3

We appreciate the opportunity to provide these comments. Members of the Committees are available to discuss them should the Commission or the staff so desire.

Respectfully submitted,

/s/ Linda L. Griggs

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Linda L. Griggs, Chair of the Committee  
on Law & Accounting

/s/ Keith F. Higgins

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Keith F. Higgins, Chair of the  
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