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February 26, 2007

Nancy M. Morris
Secretary, Securities and Exchange Commission ("SEC")
100 F Street, NE
Washington, DC 20549-1090.

Re: File Number S7-24-06 (SEC Release 33-8762: Management's Report on Internal Control Over Financial Reporting)

Dear Madam,

Cardinal Health, Inc. ("Cardinal Health") is pleased to comment on the SEC's proposed ruling related to management's report on internal control over financial reporting (the "Proposed SEC Ruling"). Overall, Cardinal Health believes that the Proposed SEC Ruling provides helpful guidance in a number of areas, particularly in the use of a top down, risk-based approach to designing and conducting management's evaluation of internal control over financial reporting ("ICFR").

However, after reviewing the Proposed SEC Ruling, we feel that there are a few areas which could benefit from some expansion or further clarification:

Impact of a Centralized Control Environment on Scoping

Section #1 of the Proposed SEC Ruling addresses identifying financial reporting risks and controls. The Proposed SEC Ruling states the methods for identifying the potential risks vary based on various company characteristics including, "…the size, complexity, and organizational structure of the company and its processes and financial reporting environment, as well as the control framework used by management."

With more and more companies taking advantage of shared services models and fully-integrated enterprise resource planning systems, it would be beneficial to provide specific guidance on considerations around the scoping process and the extent of detailed control testing required for companies operating in a shared services environment and with a fully-integrated enterprise resource planning systems.

Considerations for Acquisitions in Developing Scope

In the Frequently Asked Questions to "Management's Report on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports," (revised 10/6/2004) the SEC acknowledges that it might not always be possible to include a recent acquisition in the scope of management's assessment of ICFR, and describes the steps that management should take to disclose excluding the acquired business unit from its assessment.

It would be beneficial to include this clarification on management's responsibilities relating to a recent acquisition in the section on Reporting Considerations in the Proposed SEC Ruling.

<u>Scoping for General IT Controls</u>

Both the Proposed Ruling and PCAOB Release No. 2006-007, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements* (the "Proposed PCAOB Standard") discuss the use of a top-down, risk-based approach to identifying and evaluating management's key controls; however, there is no specific mention of how this approach would apply to the identification and evaluation of General IT Controls ("ITGC").

Companies have generally taken an "all or nothing" approach in determining the scope of ITGC testing. If an application has been identified as being in-scope (because key financial controls either reside on the application or are executed around information produced by that application), then the complete scope of ITGC has historically been examined for that application with little consideration of the risk associated with the individual components of ITGC.

The Institute of Internal Auditors ("IIA") has released guidance entitled the "Guide to the Assessment of IT General Controls Scope based on Risk" (GAIT) that is meant to help facilitate the cost-effective scoping of ITGC assessments by helping organizations identify key ITGCs where a failure might indirectly result in a material error in a financial statement. GAIT is driven by four primary principles:

1. The identification of risks and related controls in ITGC processes (e.g., in change management, deployment, access security, and operations) should be a continuation of the top-down and risk-based approach used to identify significant accounts, risks to those accounts, and key controls in the business processes.

2. The ITGC process risks that need to be identified are those that affect critical IT functionality in financially significant applications and related data.

3. The ITGC process risks that need to be identified exist in processes and at various IT layers: application program code, databases, operating systems, and networks.

4. Risks in ITGC processes are mitigated by the achievement of IT control objectives, not individual controls.

It would be beneficial for the guidance to provide some clarity on how a top-down, risk-based approach for scoping should be applied to ITGC, perhaps by incorporating some of the principles included in GAIT as described above.

<u>Definition of "Entity-Level Controls"</u>

The Proposed SEC Ruling describes "entity-level controls" in footnote 29 to include a wide variety of control activities, ranging from consideration of the control environment to the controls over the period-end financial reporting process. Given the broad scope of the definition of entity-level controls, there may be some confusion as to exactly what types of procedures are encompassed by entity-level controls.

It may be beneficial to consider refining the definition of entity-level controls to include two categories: those controls that are more general and pervasive but may not detect specific financial reporting risk (e.g. control environment), and those controls that are detailed enough to detect specific financial reporting risk (e.g. controls over the period-end financial reporting process).

In addition, it may be beneficial to consider aligning the terminology utilized in the Proposed SEC Ruling ("Entity-Level Controls") with that used in the Proposed PCAOB Standard ("Company-Level Controls") in order to avoid confusion.

Process for Identifying Financial Reporting Risk

The process to identify financial reporting risks as part of the scoping process (outlined in pages 23-26 of the Proposed SEC Ruling) could be further clarified by providing a graphic that outlines the steps of the process at a high level.

Implementing Procedures to Evaluate Evidence of the Operation of ICFR

The Proposed SEC Ruling describes the possibility that management can use ongoing monitoring procedures to evaluate the company's control environment, and that evidence about the effectiveness of those monitoring procedures can be obtained "through self-assessment procedures and the analysis of performance measures designed to track the operation of controls."

It would be beneficial for the guidance to provide specific examples of what constitutes monitoring procedures and how such monitoring procedures could be evaluated. The guidance describes self-assessment as one of the ways to evaluate monitoring procedures but does not describe how this differs from a direct test of controls. It would be beneficial if such clarification is provided.

Evaluating Evidence of the Operating Effectiveness of ICFR

Included in the discussion of Evaluating Evidence of the Operating Effectiveness of ICFR, the Proposed SEC Ruling describes a sliding scale of evidential matter required to support a control assessment based on the misstatement risk of the financial reporting element (tied closely to materiality) and the risk of control failure. For example, the assessment of a control activity with a high risk of failure in an area with a high risk of misstatement would require more evidence to support than the assessment of a control activity with a low risk of failure in an area with a low risk of misstatement.

While the Proposed SEC Ruling sites numerous examples of factors that should impact both the risk of misstatement and the risk of failure, it does not provide guidance on what is considered to be "more" versus "less" evidential matter. It would be beneficial if such guidance is provided

The "Proposed PCAOB Standard discusses the testing techniques that are appropriate for gathering evidence as part of the external auditor's testing of controls. They are, in order of the evidence that they ordinarily would produce, from least to most: inquiry, observation, inspection of relevant documentation and reperformance of a control. Currently, external auditors generally rely heavily on inspection and reperformance as the preferred evidence of the effectiveness of controls.

It would be beneficial to provide some correlation between the evidence provided by the various testing techniques described in Proposed PCAOB Standard and the Proposed SEC Ruling on Evaluating Evidence of the Operating Effectiveness of ICFR. Such correlation would assist management and a company's external auditors in determining the appropriate level of evidence to support management's assessment of ICFR.

<u>Clarification of Definitions Used in the Evaluation of Deficiencies</u>

The Proposed SEC Ruling describes a material weakness as "a deficiency, or combination of deficiencies, in ICFR such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis by the company's ICFR."

In using the term "reasonable possibility" as indicated above, the Proposed SEC Ruling states that "there is a reasonable possibility of an event when the likelihood of an event is either 'reasonably possible' or 'probable' as those terms are used in Financial Accounting Standards Board Statement No. 5, *<u>Accounting for Contingencies</u>*." These definitions, however, remain vague and open to a great deal of interpretation when attempting to determine the likelihood that a deficiency may occur.

It would be beneficial for the Proposed SEC Ruling to more clearly define the term "reasonable possibility" within the body of the Proposed SEC Ruling, as well as perhaps provide some examples or guidance on the thresholds of "reasonable possibility".

<u>Company Responsibility for Significant Deficiencies</u>

Currently, pursuant to PCAOB Auditing Standard #2, auditors are required to identify significant deficiencies and material weaknesses in the course of auditing Management's Assessment of ICFR. However, the Proposed PCAOB Standard attempts to steer auditor emphasis away from identifying significant deficiencies and to rather focus on identifying material weaknesses. While the Proposed SEC Ruling provides a definition of a material weakness as well as a detailed explanation of a company's responsibilities in the event that a material weakness has been identified, there is no such guidance with respect to significant deficiencies. This can lead to confusion as it is may be difficult for a company and its auditors to agree on what is required to remediate a significant deficiency since the Proposed SEC Ruling does not define the term significant deficiency. Additionally, it is likely that many audit firms will continue to take a conservative approach in their audit of Management's Assessment of ICFR and plan their audits at a level designed to identify significant deficiencies.

It would be beneficial for the Proposed SEC Ruling and the Proposed PCAOB Standards to provide similar guidance on treatment of significant deficiencies in order to alleviate confusion between companies and their auditors.

Sincerely,

Eric Slusser
EVP, Chief Accounting Officer & Controller