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Via e-mail to rule-comment@sec.gov

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

Subject: File No. S7-06-03

Dear Ms. Morris,

Thank you for the opportunity to comment on the SEC's proposed rule release no. 33-8731 (file no. S7-06-03) on Internal Control Over Financial Reporting in Exchange Act Periodic Reports of Non-Accelerated Filers and Newly Public Companies.

I have worked both as an internal auditor and as a controller and have followed the SEC and PCAOB rules and guidance, comment letters and studies by various third parties. I hope that my comments will be useful in the SEC's and the PCAOB's efforts to make assessments of internal control over financial reporting more cost effective.

Please find my comments to the SEC's questions below.

Is it appropriate to provide a further extension of the compliance dates of the internal control over financial reporting requirements for non-accelerated filers?

Yes. The management's assessment of internal control over financial reporting and the auditor's attestation to management's assessment have a strong fixed cost element, which is not related to company size. As a consequence, smaller public companies bear a higher percentage cost for management's assessment of internal control over financial reporting and the auditor's attestation to management's assessment in relation to their size.

The ultimate objective of the Securities Act, the Securities Exchange Act and the Sarbanes-Oxley Act is the protection of investors. In the case of management's assessment of internal control over financial reporting and the auditor's attestation to management's assessment, it is the investor that pays the cost for this investor protection measures and the investors will consequently receive a lower net profit. The SEC should carefully analyze costs and benefits and try its utmost to lower costs before requiring smaller public companies to comply with section 404(a) or section 404(b) of the Sarbanes-Oxley Act.

If so, are the proposed extensions for compliance with management and auditor attestation report requirements appropriate in length or should they be shorter or longer than proposed?

As far as management's assessment of internal control over financial reporting is concerned, the SEC is in the best position to consider how long it will take the SEC to analyze the comment letters on its concept release, to draft and publish a proposed rule, to analyze comment letters on the proposed rule and to draft and publish a final rule on management's assessment of internal control over financial reporting. Ideally, the final rule should be available at the beginning of most issuer's fiscal year so that they have sufficient time to revise the internal methodologies and guidelines for management's assessment, to translate it into several languages, to communicate it through their organization and to train their employees.

Due to the risk that the cost of compliance with section 404 will be too high for smaller public companies to be commensurate with any benefits, the SEC should consider whether it should not wait until after the first audit of internal control over financial reporting at accelerated filers using the revised AS No. 2 has taken place and after those audits using the revised AS No. 2 have been inspected by the PCAOB for the first time to see if the revisions are really working and to see if significant savings in assessment costs and audit fees were achieved.

Should the Commission consider a further extension if the revisions to Auditing Standard No. 2 and the release of guidance for management are not completed in sufficient time to permit issuers and auditors to rely on them?

Yes, definitely.

Is it appropriate to implement sequentially the requirements of Section 404(a) and (b) of the Sarbanes-Oxley Act, as proposed, so that a non-accelerated filer would only have to include management's internal control assessment in the annual report that it files for its first fiscal year ending on or after December 15, 2007 and would not have to begin providing an accompanying auditor's attestation report until it files an annual report for a fiscal year ending on or after December 15, 2008?

Yes. Any delay is certainly beneficial. The audit of internal control over financial reporting requires extra time being spent by accounting staff, internal audit staff and management on interaction with the auditor and preparing information based on auditor requests. The first management assessment is likely to take more time, so having more time to focus just on one task is beneficial.

Would the phasing-in of the management assessment requirement and auditor attestation report requirement make the ultimate application of Auditing Standard No. 2 more or less efficient and effective?

On the other hand agreeing up front with the auditor on the methodology, the assessment of certain risks, the selection of controls to test and sample sizes to test is key. If management's methodology is not considered adequate by the auditor, he will

not use management's work as the "work of others" and management's effort will be wasted and the testing will be extensively reperformed by the auditor.

Is it appropriate to deem the management report on internal control over financial reporting to be "furnished" rather than "filed" during the first year of a non-accelerated filer's compliance with the Section 404 requirements? If so, is it also appropriate to take the same action during the first year of compliance with the Section 404 requirements by a foreign private issuer that is an accelerated filer, but not a large accelerated filer, and that files its annual reports on Form 20-F or 40-F?

Yes. I think management's fear of being getting second-guessed in a court of law is certainly an issue.

Would management's assessment of internal control over financial reporting provide meaningful disclosure to investors, independent of the auditor attestation report? Is there an increased risk that management will fail to identify a material weakness in the company's internal control over financial reporting, and if so, do the potential benefits of the proposal outweigh this risk?

Yes. I think the disclosure would still be meaningful. Management will hopefully have the SEC's final rule on management's assessment, the COSO framework, the COSO guidance for smaller public companies and the old or revised AS No. 2. This should do to come up with a decent testing methodology.

Are the proposed extensions in the best interests of investors?

Yes. Investors ultimately pay for management's assessment and the auditor's attestation because they are expenses of the company and because they reduce net profit. Any action by the SEC that can lower those costs and improve the balance of costs and benefits is in the best interest of investors.

Should we require a non-accelerated filer to disclose in its annual report that management's assessment has not been attested to by the auditor during the year that the audit attestation report is not required?

Yes. This would be more reader friendly and transparent.

Simultaneously with the publication of this release, we are issuing a separate release to extend the date by which a foreign private issuer that is an accelerated filer (but not a large accelerated filer), and that files its annual reports on Form 20-F or 40-F, must begin to comply with the auditor attestation report portion of the Section 404 requirements. Is there any additional relief or guidance that we should consider specifically with respect to foreign private issuers?

Not, but the elimination of the reconciliation requirement between IFRS and US GAAP would remove the extra complexity of keeping books according to two sets of standards, which adds extra complexity and is a source of errors.

Do the timing requirements for initial compliance with the internal control reporting requirements make it overly burdensome or costly to undertake an initial public offering or public listing in the U.S.? Do they otherwise discourage companies from undertaking initial public offerings or seeking public listings in the U.S.? Is the proposed relief appropriate and in the interest of investors? Is some other type of relief appropriate?

Speaking from a European perspective and from the perspective of the private equity industry for which listing portfolio companies is one of several exit routes, the compliance cost of being an issuer that is subject to the periodic reporting requirements and especially section 404 compliance costs and US GAAP reconciliation requirements, speak in favour of listing on a European rather than a U.S. stock exchange (assuming all other things being equal).

I think the SEC should follow the primary recommendations of its Advisory Committee on Smaller Public Companies, especially the primary recommendations concerning section 404. Those recommendations and the meeting minutes makes seem very sensible to me as a controller and an ex internal auditor.

Should newly public companies, or a subgroup of newly public companies, be given additional time after going public before they are required to include management and auditor attestation reports on internal control over financial reporting in their annual reports filed with the Commission? If so, how much time? Should we propose a transition period only for companies that become public in the third or fourth quarter of their fiscal year?

Exceptions should be based on the size of an issuer. Any issuer contemplating going public should prepare well in advance. If an issuer decides to go public in Q3 or Q4 he simply needs to start his preparations early enough.

As an alternative to the proposed transition period, should we require a newly public company to include management's assessment, but not the auditor's attestation report on management's assessment in the first annual report that the company is required to file?

No.

Would the proposed transition period allow newly public companies to complete their internal control reporting processes more efficiently and effectively? Would it improve the quality of internal control reporting by newly public companies?

I think so. It will allow better preparation rather than doing the assessment under stress in a hurry.

The rule is a major rule since the cumulated annual compliance costs of section 404 of all non-accelerated filers once the compliance dates are reached will certainly be in excess of USD 100 mio. The SEC Office of Economic Analysis provided data on the number of smaller public companies and the SEC cites studies showing average auditor's fees for a section 404 (b) attestation between USD 300'000 and 475'000.

The legislative history of section 404 in the Senate Committee on Banking, Housing and Urban Affairs report shows that congress did not intend the section 404 (b) attestation to be the basis for any increase audit fees. Considering the fact that the average section 404 compliance costs per issuer excluding audit fees for section 404 (b) attestations were 34 times higher than the SEC's cost estimation of USD 91'000 as part of the Cost-Benefit-Analyses in the SEC's initial final rule on section 404 (Release No. 33-8238). In addition, it is hard to understand the SEC's comment that the cost estimate "however, excludes several costs attributable to Section 404. The estimate does not include the costs associated with the auditor's attestation report, which many commenters have suggested might be substantial.". The cost of the 404(b) attestation is part of the cost of the rule and the SEC had the obligation to include all relevant costs in order to make a meaningful cost-benefit analysis and to decide whether smaller issuers should be exempted or not. I think the SEC owes the public a thorough cost-benefit analysis on section 404 using an intuitive metric, such as 404 compliance costs as a % of net earnings before section 404 compliance costs for different sizes classes of issuers.

Apart from commenting on this proposed rule, I would like to point out that it seems that the SEC's own internal control over the management and publication of comment letters is not working. The following comment letters have been published under the file no. S7-06-03 although their content makes it obvious that they relate to file no. S7-12-06 Amendments to Regulation SHO:

Aug. 12, 2006 comment letter from Robert Callahan

Aug. 12, 2006 comment letter from Maggie Butler (also filed under S7-12-06)

Aug. 12, 2006 comment letter from Frank Cullen

Aug. 12, 2006 comment letter from Rob Rzeppa (also filed under S7-12-06)

It is possible, that the authors of those comment letters posted them via the form on the SEC's website and simply clicked on the wrong "Submit comments on ..." link because the two proposed rules are physically close to each other on the webpage. However, SEC staff should timely review incoming comment letters and reclassify them to the correct file no. if it becomes obvious from their content that they belong to a different file no.

Yours sincerely

Georg Merkl