ASSOCIATION OF CORPORATE COUNSEL
Corporate & Securities Committee
1025 Connecticut Ave. NW
Washington, DC 20036

April 12, 2005

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

Securities and Exchange Commission
450 Fifth St., N.W.
Washington, D.C. 20549
Attention: Jonathan G. Katz, Secretary

Re April 13th Roundtable On Implementation Of Internal Control Reporting Provisions

Ladies and Gentlemen:

On behalf of the Association of Corporate Counsel ("ACC" or the "Association"), ACC's Corporate & Securities Committee is pleased to respond to the request of the Securities and Exchange Commission (the "SEC" or the "Commission") for feedback regarding the experiences of registrants and others in implementing the new internal control requirements under Section 404 of the Sarbanes-Oxley Act of 2002 ("SOX"). ACC has more than 16,500 individual members who act as in-house counsel to more than 7,500 business entities. Its members represent 49 of the Fortune 50 companies and 98 of the Fortune 100 companies. Internationally, its members represent 42 of the Global 50 and 74 of the Global 100 companies. The Corporate & Securities Committee is the largest of ACC's committees, with over 6,200 attorney members, a significant amount of whom work in public companies subject to the Commission's disclosure requirements.

Many of the Association's members not only serve in a legal capacity but as compliance officers for their respective corporations, and all of the Corporate & Securities Committee members have an interest, if not direct involvement, in the effective implementation of the SOX internal control provisions.

One of the greatest areas of concern expressed by the Association's members is the often high cost associated with compliance. As several other commentators have noted, the compliance costs for public companies are significant. Leon J. Level, in his March 7, 2005 letter to the Commission, cites numerous studies including one by AMR Research indicating that the cost of compliance may be $1 million for every $1 billion in revenue. While we endorse the goals of Section 404 and believe that strong internal controls are important to reinforce faith in the integrity of our markets, it seems that the cost associated with compliance may be disproportionate to the benefits obtained by compliance, particularly the costs (both in dollar costs and in personnel time) associated

with the extent of documentation and testing required to complete an adequate assessment. At times, it appears that the accounting firms are taking the most risk-averse approach, resulting in the potential of "documentation for documentation's sake" rather than focusing on those controls that are most important to the integrity of the company's financial reporting process.

Section 404 of SOX was intended to prevent or at least limit fraud in the public financial markets. Unfortunately, like many other sections of the legislation, it does not solve perceived problems with fine precision, but with broad brush strokes. Fortunately, the SEC and the Public Company Accounting Oversight Board have the opportunity to refine the process by enhancing the rules so that the goals of Section 404 can be achieved at a reasonable cost. We believe that a considered refinement and streamlining of the rules should reduce the cost of compliance, without diminishing Section 404's effectiveness. Please note that the cost-benefit ratio may be most severe among the smaller public companies, and we feel that some reasonable accommodation should be made for smaller companies while ensuring that intent of the Act is equally effective.

In addition to the cost issues, we would like to address some definitional issues of concern to our members:

Definition of Significant Deficiency

We believe that "significant deficiency" during the 2004 reporting season has in fact encompassed a large number of internal control deficiencies that are not truly "significant," and we therefore recommend that the definition of "significant deficiency" be reconsidered. Significant deficiency is currently defined in paragraph 8 of Auditing Standard No. 2 (the "Standard") as:

> An internal control deficiency that adversely affects the company's ability to initiate, record, process, or report external financial data reliably in accordance with generally accepted accounting principles. A significant deficiency could be a single deficiency, or a combination of deficiencies, that results in more than a remote likelihood that a misstatement of the annual or interim financial statements that is more than inconsequential in amount will not be prevented or detected.

The Standard refers to the definition of "remote" as used by Financial Accounting Standards Board Statement No. 5 ("FAS 5"), meaning the change of the future event or events occurring is slight. Therefore, as used by the Standard, any internal control deficiency that results in a more than slight likelihood of a misstatement of a more than inconsequential amount to the financial statements is deemed to be a significant deficiency. For purposes of FAS 5, "slight" is generally interpreted as less than 20% likelihood. Combining the "more than slight likelihood" with "more than inconsequential" generally results in a disproportionate number of deficiencies being deemed to be a "significant deficiency." The vast majority of internal control

deficiencies are likely to be deemed to be significant deficiencies using this criteria, even if they are not, in fact, actually significant to an issuer.

We believe the definition should be revised to include internal control deficiencies that result in more than a remote likelihood that a misstatement of the annual or interim financial statements that is significant in amount will not be prevented or detected.

In addition, while we recognize the rules require a significant deficiency to be disclosed only to the audit committee, and not in a public filing, we note that many auditors, as well as some state regulators, are now requiring public disclosure of significant deficiencies. This public disclosure creates the perception that the "significant deficiency" is as important as a "material weakness" when that is not always the case. We believe it is important to revise the definition as indicated above and to reaffirm that public disclosure of such "significant deficiency" is not required.

Use of Judgment in Characterizing Internal Control Deficiencies

Paragraphs 116-127 of the Standard provide guidance on forming an opinion on the effectiveness of internal control over financial reporting. These paragraphs suggest that companies and auditors should apply careful thought and analysis before reaching a conclusion as to the nature of an internal control deficiency. Paragraph 126 of the Standard lists certain circumstances that should be regarded as at least a significant deficiency and are strong indicators that a material weakness in internal control over financial reporting exists, including (A) "Restatement of previously issued financial statements to reflect the correction of a misstatement" and (B) "Significant deficiencies that have been communicated to management and the audit committee, but that remain uncorrected after some reasonable period of time."

With respect to (A) above, we understand that many accounting firms are taking the position that any restatement of previously issued financial statements to reflect the correction of a misstatement is automatically considered a material weakness, regardless of the specific facts and circumstances. In particular, many accounting firms have taken the position that a restatement due to the recent clarification of lease accounting is automatically a material weakness. It appears that the accounting firms are taking the most risk-averse approach, resulting in internal control deficiencies being characterized as more serious than would otherwise be appropriate. It is important that such automatic conclusions are not reached, but that judgment should always be applied in determining whether a significant deficiency or material weakness exists.

With respect to (B) above, we respectfully request that the commission clarify that this refers only to a specific, identified significant deficiency that remains uncorrected. For example, if a significant deficiency in the area of general computer controls exists and is corrected, but a new significant deficiency arises in the area of general computer controls, (B) would not necessarily require the conclusion that a significant deficiency or material weakness exists.

Changes in Internal Control Over Financial Reporting

It would also be helpful if the rules provided additional guidance on what constitutes a "change in the registrant's internal control over financial reporting" that would require disclosure in quarterly and annual reports pursuant to Item 401 of Regulation S-K. When will such a change be deemed to "materially affect, or be reasonably likely to materially affect, the registrant's internal control over financial reporting"? Does this refer only to changes that materially affect the registrant's internal control over financial reporting taken as a whole? Or does it include a material change to a single control, even if that control is only one small piece of the registrant's overall internal control scheme?

We are pleased to be able to offer our comments and we hope that this letter will constitute a useful contribution to the debate. Should you wish to discuss it with us, please call the undersigned at 317-488-6264.

Cordially,

/s/ Michael C. Wyatt

ASSOCIATION OF CORPORATE COUNSEL

By: Michael C. Wyatt
Chair, Corporate & Securities Committee

cc: Hon. William H. Donaldson
Chairman of the Securities and Exchange Commission

Hon. Paul Atkins
Commissioner

Hon. Roel Campos
Commissioner

Hon. Cynthia A. Glassman
Commissioner

Hon. Harvey Goldschmid
Commissioner

Alan L. Beller, Director
Division of Corporation Finance