

## Appendix A

**Question 1: Would additional guidance to management on how to evaluate the effectiveness of a company's internal control over financial reporting be useful? If so, would additional guidance be useful to all reporting companies subject to the Section 404 requirements or only to a sub-group of companies? What are the potential limitations to developing guidance that can be applied by most or all reporting companies subject to the Section 404 requirements?**

Yes, additional principle-based guidance would be useful to all companies (and all interested parties), with the objective of reducing the burden and cost for all registrants. Guidance in whatever form from the Securities and Exchange Commission (the "**Commission**") should permit management's interpretation and judgement to be applied to the specific circumstances of each organisation. Since this is the first year of mandatory compliance with Section 404 for foreign private issuers ("**FPIs**"), guidance should be prospective in nature, and management's interpretation of the "Staff Statement on Management's Report on Internal Control Over Financial Reporting" released on May 16, 2005 (the "**May 16, 2005 Guidance**") should be considered appropriate for the current reporting cycle. The Commission should provide a timetable for publishing future guidance.

It is critical to ensure that there is consistency in the interpretation and understanding of what is expected of management's evaluation process by management and by the external auditors. Importantly, any guidance issued by the Commission needs to be reflected in and coterminous with guidance issued by the PCAOB for external auditors.

Additionally, registrants would welcome the opportunity to comment on a draft before the Commission issues final guidance. Furthermore, registrants should also be offered the opportunity to comment on proposed amendments to Auditing Standard No. 2, "An Audit of Internal Control Over Financial Reporting Performed in Conjunction with An Audit of Financial Statements" ("**AS 2**").

**Question 2: Are there special issues applicable to foreign private issuers that the Commission should consider in developing guidance to management on how to evaluate the effectiveness of a company's internal control over financial reporting? If so, what are these? Are such considerations applicable to all foreign private issuers or only to a sub-group of these filers?**

Yes, there are special issues, examples of which are set out below, that apply to FPIs.

- FPIs bear an additional financial burden because we must comply with Section 404 and prepare Form 20-F, including a US GAAP reconciliation of local GAAP accounts, in addition to complying with our domestic requirements. At the same time, our shareholders, potential investors and analysts generally do not review their investment decisions based on our Form 20-Fs and US GAAP information, nor do we manage our businesses on a US GAAP basis. As a result, the cost-benefit balance of Section 404 is more disadvantageous for FPIs.
- FPIs are cognisant of and must align themselves with applicable local regulatory and statutory requirements (e.g., the Turnbull Report in the UK). Local legislation and regulatory requirements continually evolve and are of a scale and nature that is likely to create an additional burden and cost for FPIs and compete for the use of their scarce resources. Two examples in the UK are The Companies Act and The Finance Act.
- Many FPIs are still in a transitional period of embedding International Financial Reporting Standards (“IFRS”), and IFRS standards have still to be finalised for a number of sector specific accounting matters.
- Many FPIs do not file quarterly reports and some do not file interim reports.
- Multi-locational issues are likely to be more important for FPIs.
- There is often a time gap between the publication of domestic and US GAAP-reconciled results, as GAAP conversion and preparation of annual reports on Form 20-F may follow the publication of the domestic annual report.

We request that the Commission take these differences into account in developing future guidance regarding the implementation of Section 404. For example, management should be allowed to exercise their judgement by determining scope and materiality decisions based entirely on primary GAAP. More generally, avoiding duplication of effort by allowing for greater reliance on FPIs' primary market regulatory and statutory corporate governance requirements would also be a positive step forward.

**Question 3: Should additional guidance be limited to articulation of broad principles or should it be more detailed?**

Commission guidance should be based on broad principles supported by detailed examples that enable management to comply with the Sarbanes-Oxley Act of 2002 (the “**Act**”) with less burdensome cost to stakeholders.

Precisely because of concerns that an over reliance on rule-based financial reporting contributed to the problems the Act was meant to address, Section 108(d) of the Act charged the Commission with the preparation of a study on the adoption of principle-based financial reporting.<sup>1</sup> The study concluded that principle-based accounting standards are consistent with the vision of reform the Act was meant to implement and accordingly advocated the adoption of such standards. The guidance we are seeking would therefore be consistent with the conclusions of the study.

---

<sup>1</sup> “Study Pursuant to Section 108(d) of the Sarbanes-Oxley Act of 2002 on the Adoption by the United States Financial Reporting System of a Principles-Based Accounting System”, available at <http://www.sec.gov/news/studies/principlesbasedstand.htm>.

**Question 4: Are there additional topics, beyond what is addressed in this Concept Release, that the Commission should consider issuing guidance on? If so, what are those topics?**

We support the top-down, risk-based approach outlined in the May 16, 2005 Guidance and have set out herein those areas where we would welcome further principle-based guidance from the Commission.

**Question 5: Would additional guidance in the format of a Commission rule be preferable to interpretive guidance? Why or why not?**

Broad, principle-based guidance that expands the May 16, 2005 Guidance and that can be interpreted by management through the application of its judgement to the specific circumstances facing each organisation is preferred to a rules-based approach. Nonetheless, if it were feasible to incorporate these broad principles within a rule from the Commission that supported the application of management's judgement and defined the boundary of the evaluation process to be applied by management that would also be welcome.

The Commission should provide a safe harbour from liability for the application of management's judgement and interpretation of the Commission guidance and/or the Act itself provided that the Commission's guidance is followed. Whether in the form of principle-based guidance or a new rule, guidance should ensure the alignment, clarification and consistency of the requirements placed on management and the external auditor by the Act.

Such a safe harbour should be accompanied by a corresponding safe harbour available to external auditors attesting to management's assessments performed in accordance with the revised Commission guidance. This would increase the alignment between the method of application by management and auditors of the applicable requirements.

**Question 6: What types of evaluation approaches have managements of accelerated filers found most effective and efficient in assessing internal control over financial reporting? What approaches have not worked, and why?**

Approaches that are currently still being implemented and have embraced the May 16, 2005 Guidance – a top-down, risk-based approach – appear to have worked well but have yet to be tested in a live year for most FPIs. However, full implementation of the May 16, 2005 Guidance remains hampered by the conflict that exists between the true application of a top-down, risk-based approach and the requirements placed on auditors under AS 2 and/or the interpretation of AS 2 that is being applied by some external auditor firms. For example, the effective use and benefit from the documentation and testing of entity-level controls and the linkage to a real reduction in the nature, timing and extent of documentation and testing of transaction level controls is proving a real challenge. This is a specific area upon which we would welcome guidance.

Over-reliance was originally placed on bottom-up transactional level control documentation and testing to achieve high statistical coverage rates, regardless of the risk of material misstatement. Conservative and inconsistent interpretations of AS 2 by external auditors before the May 16, 2005 Guidance from the Commission resulted in these approaches being applied. The application of documentation and testing standards that have been driven by AS 2, rather than what we believe is required to genuinely support management’s evaluation process, has led to inefficiencies in terms of resources, cost and time. In particular, management’s use of its cumulative knowledge and experience with respect to the effectiveness of controls in the business, management’s self-assessment and the use of monitoring controls were not considered appropriate. Additionally, there has been an inappropriate focus on the testing of controls that are applied “as of” the indicated measurement date as opposed to those that could be tested more effectively and efficiently throughout the period.

**Question 7: Are there potential drawbacks to or other concerns about providing additional guidance that the Commission should consider? If so, what are they? How might those drawbacks or other concerns best be mitigated? Would more detailed Commission guidance hamper future efforts by others in this area?**

We refer the Commission to our answers to questions 1, 2, 3 and 5 above.

**Question 8: Why have the majority of companies who have completed an assessment, domestic and foreign, selected the COSO framework rather than one of the other frameworks available, such as the Turnbull Report? Is it due to a lack of awareness, knowledge, training, pressure from auditors, or some other reason? Would companies benefit from the development of additional frameworks?**

The experience of most FPIs is that management felt compelled to accept COSO over and above other control frameworks that have as their foundation the principles enshrined in COSO. The reasons for this include US registrant peer pressure, external auditor pressure and the more widespread general use of the COSO framework and its supporting guidance.

We do not believe that companies would necessarily benefit from the development of additional internal control frameworks that are equivalent to COSO. However, the COSO framework should continue to evolve to recognise the changing nature of international organisations and best practice thinking on control.



**Question 9: Should the guidance incorporate the May 16, 2005 “Staff Statement on Management’s Report on Internal Control Over Financial Reporting”? Should any portions of the May 16, 2005 guidance be modified or eliminated? Are there additional topics that the guidance should address that were not addressed by that statement? For example, are there any topics in the staff’s “Management’s Report on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports Frequently Asked Questions (revised October 6, 2004)” that should be incorporated into any guidance the Commission might issue?**

Yes, the Commission should incorporate the May 16, 2005 Guidance. None of the May 16, 2005 Guidance should be eliminated, and we encourage the Commission not to modify the May 16, 2005 Guidance in a manner that reduces the ability of management to apply its judgement in interpreting Section 404.

We have highlighted in our responses to other questions herein the additional guidance requested from the Commission.

Such new guidance should also incorporate any guidance set out in the Frequently Asked Questions (revised October 6, 2004) that is not inconsistent with the new guidance.

**Question 10: We also seek input on the appropriate role of outside auditors in connection with the management assessment required by Section 404(a) of Sarbanes-Oxley, and on the manner in which outside auditors provide the attestation required by Section 404(b). Should possible alternatives to the current approach be considered and if so, what? Would these alternatives provide investors with similar benefits without the same level of cost? How would these alternatives work?**

The value of the management attestation requirement and the investor protection benefits generated by the enhanced requirements to assess the effectiveness of internal controls should not be underestimated, nor should the deterrent effects of the additional civil and criminal penalties adopted in recent years for financial reporting failures. There is not complete conviction that the application of the auditor attestation requirement is worth all of the cost and burden associated with it, and there is currently significant duplication of effort in terms of documentation and testing of controls. We therefore feel that more cost benefit analysis should be performed to consider whether keeping this requirement in its present form is justified.

Nonetheless, if the Commission reduces the burden and cost associated with the application of the auditor attestation requirement, this should in turn reduce our concerns about the value of the audit requirement. Indeed, if these improvements facilitate a more rational application by auditors of the applicable requirements, including effective integration of the financial statement and internal control audits, the cost benefit analysis would probably tip in favour of keeping the requirement.

Alternative options to the current approach that might provide investors with similar benefits without the same level of cost include:

- auditor attestation on management's evaluation process only;
- reducing the frequency of the auditor's attestation to once every few years;
- permitting the use of rotational testing by management and the external auditor;
- replacing the auditor's attestation by negative assurance, e.g., the existing Turnbull sign-off given by auditors in the UK; and
- eliminating the requirement in AS 2 for the auditor to cover a large portion of a company's operations and permitting the application of professional judgement.

It is also worth noting that the EU and individual European national regulators have not adopted a similar external auditor requirement.

If the proposed guidance does not succeed in achieving the alignment of the requirements applicable to management and auditors, thereby enabling auditors to place more reliance upon management's work, removal of the auditor attestation requirement should be given consideration.

**Question 11: What guidance is needed to help management implement a “top-down, risk-based” approach to identifying risks to reliable financial reporting and the related internal controls?**

We support the top-down, risk-based approach outlined in the May 16, 2005 Guidance and have set out herein those areas where we would welcome further principle-based guidance from the Commission.

**Question 12: Does the existing guidance, which has been used by management of accelerated filers, provide sufficient information regarding the identification of controls that address the risks of material misstatement? Would additional guidance on identifying controls that address these risks be helpful?**

No, the existing guidance needs to be clarified. Additional guidance is required to clarify the statement made in the May 16, 2005 Guidance that management's focus for scoping purposes should be driven by appropriate quantitative and qualitative criteria that are determined by the risk of a material misstatement. Clarification of the application of the concept of a material misstatement in the context of Section 404 is requested, and should cover both financial statements (including balance sheet reclassifications) and related disclosures.

Any guidance issued by the Commission should be careful not to confuse the use of the words "significant" and "material". For example, the existing guidance on and definition of "material weaknesses" appear to be in conflict. Specifically, the definitions provided by AS 2 and the focus of the May 16, 2005 Guidance's top-down, risk-based approach are not aligned. AS 2 provides examples that suggest a number of significant deficiencies can result in a material weakness, which has resulted in a focus on significant rather than material errors leading to testing on a more detailed level than is appropriate. Another example of AS 2 and the May 16, 2005 Guidance not being aligned is in the use of the word "significant" rather than material in appendix B1 of AS 2 to describe which locations should be considered by the auditors.

Principle-based guidance on the timing and review of scoping of internal controls that addresses the risk of material misstatement is requested. In addition, we request guidance on when a re-scoping should be performed to reflect changes in the business within a period.

Principle-based guidance is also requested on the application of quantitative and qualitative criteria to identify risks of material misstatement in multi-location businesses.

**Question 13: In light of the forthcoming COSO guidance for smaller public companies, what additional guidance is necessary on risk assessment or the identification of controls that address the risks?**

We do not think that this question is applicable for the members of The Hundred Group of Finance Directors (the “**Hundred Group**”).

**Question 14: In areas where companies identified significant start-up efforts in the first year (e.g., documentation of the design of controls and remediation of deficiencies) will the COSO guidance for smaller public companies adequately assist companies that have not yet complied with Section 404 to efficiently and effectively conduct a risk assessment and identify controls that address the risks? Are there areas that have not yet been addressed or need further emphasis?**

We do not think that this question is applicable for the members of the Hundred Group.

**Question 15: What guidance is needed about the role of entity-level controls in evaluating and assessing the effectiveness of internal control over financial reporting? What specific entity-level control issues should be addressed (e.g., GAAP expertise, the role of the audit committee, using entity-level controls rather than low-level account and transactional controls)? Should these issues be addressed differently for larger companies and smaller companies?**

Principle-based guidance that sets out the role of entity-level controls in the following three key areas is requested:

- Entity-level controls that can be used to support management’s top-down risk assessment and the qualitative and quantitative criteria used to identify significant accounts and related controls;
- Entity-level controls that can be tested as an alternative to the testing of detailed transactional controls; and
- Entity-level controls that support management’s cumulative knowledge and experience with respect to the effectiveness of internal control over financial reporting, for example, to support the reduction or elimination of testing of transaction controls in multi-location businesses and to be supportive of rotational testing;

Guidance is also requested on what “pervasive” means in AS 2 for a multi-location organisation and the degree of evidence that is considered appropriate in each of the above three areas.

Furthermore, guidance is requested where some entity-level controls are not effective, in particular on the consequential impact on the identification of key controls and the documentation and testing of those controls in each of the above three areas.

We also request that the Commission acknowledge that the selection and application of different weightings of importance of specific entity-level controls will be unique to each organisation and may vary by location.

**Question 16: Should guidance be given about the appropriateness of and extent to which quantitative and qualitative factors, such as likelihood of an error, should be used when assessing risks and identifying controls for the entity? If so, what factors should be addressed in the guidance? If so, how should that guidance reflect the special characteristics and needs of smaller public companies?**

No formal guidance is required, but we request that the Commission acknowledge that the selection and application of different quantitative and qualitative criteria is a management judgement, is unique to each organisation and may vary by location. These criteria should include consideration of the risks associated with manual processes, IT applications and end-user computing.

As acknowledged in the May 16, 2005 Guidance, the Commission should continue to emphasise that the application of quantitative and qualitative criteria should be focused only on identifying areas of risk that give rise to a material impact on the financial statements.

We further request that the Commission ensure the risk assessment qualitative and quantitative criteria set out in AS 2 are aligned to the May 16, 2005 Guidance and subsequent guidance that may be released.



**Question 17: Should the Commission provide management with guidance about fraud controls? If so, what type of guidance? Is there existing private sector guidance that companies have found useful in this area? For example, have companies found the 2002 guidance issued by the AICPA Fraud Task Force entitled “Management Antifraud Programs and Controls” useful in assessing these risks and controls?**

No formal guidance is required, but we request that the Commission acknowledge that the identification of fraud controls is a management judgement, is unique to each organisation and may vary by location.

As acknowledged in the May 16, 2005 Guidance, the Commission should continue to emphasise that the identification of controls should be focused on identifying those fraud controls that mitigate the risk of a material impact on the financial statements (with the exception of controls related to any fraud by senior management, all of which will be included).

**Question 18: Should guidance be issued to help companies with multiple locations or business units to understand how those affect their risk assessment and control identification activities? How are companies currently determining which locations or units to test?**

No further formal guidance is required, but we request that the Commission acknowledge that the selection and application of different quantitative and qualitative criteria is a management judgement, is unique to each organisation and may vary by business area and/or location.

As acknowledged in the May 16, 2005 Guidance, the Commission should continue to emphasise that coverage is not the sole criterion and that the application of quantitative and qualitative criteria by management in their risk assessment should be focused on selecting only business areas and/or locations that give rise to a material impact on the financial statements.

We further request that the Commission ensure the risk assessment qualitative and quantitative criteria set out in AS 2 are aligned to the May 16, 2005 Guidance and subsequent guidance that may be released. In particular, we recommend that the Commission remove the terminology in AS 2 that requires the auditor to audit a “large portion” of a company’s operations.

**Question 19: What type of guidance would help explain how entity-level controls can reduce or eliminate the need for testing at the individual account or transaction level? If applicable, please provide specific examples of types of entity-level controls that have been useful in reducing testing elsewhere.**

As requested in our response to question 15, we recommend that the Commission provide principle-based guidance that sets out the role of entity-level controls that can be:

- tested as an alternative to the testing of detailed transactional controls and/or
- used to support management's cumulative knowledge and experience with respect to the effectiveness of internal control over financial reporting, for example, to support the reduction or elimination of testing of transaction controls in business areas/locations and to be supportive of rotational testing.

In adopting a top-down, risk-based approach, we are seeking to use a selection or combination of the following entity-level controls to support management's judgement in the identification of significant accounts and/or to reduce or eliminate testing at the individual account or transactional level, although we continue to experience difficulty achieving such reductions and eliminations (this list is not meant to be exhaustive, prescriptive or company specific):

- Governance and delegations of authority
- Committee structures, communication and reporting lines
- Audit Committee
- Disclosure Committee
- Code of Conduct
- Anti-fraud programmes
- Whistleblowing
- Senior management review
- Budgeting and forecasting
- Financial analysis and analytical review
- Financial monitoring controls
- Risk management framework
- Financial accounting policies and procedures manuals
- IT general controls and change management
- GAAP expertise
- Account ownership and self-certification
- Human Resources controls (specifically recruitment and competency training)
- Internal audit

**Question 20: Would guidance on how management’s assessment can be based on evidence other than that derived from separate evaluation-type testing of controls, such as on-going monitoring activities, be useful? What are some of the sources of evidence that companies find most useful in ongoing monitoring of control effectiveness? Would guidance be useful about how management’s daily interaction with controls can be used to support its assessment?**

Yes, we request principle-based guidance on how management’s assessment can be based on evidence other than that derived from separate independent testing, such as ongoing monitoring controls and management’s daily interaction with controls.

In adopting a top-down, risk-based approach, we are using a selection or combination of the following alternatives to separate independent testing of transactional controls (this list is not meant to be exhaustive, prescriptive or company specific):

- Embedded senior management and committee reviews of key performance indicators of the operation of effective control;
- Analytical review at business areas/locations or process levels compared to expected results/performance;
- Embedded monitoring and supervisory controls (not performed by the control operator) supported by quality assurance reviews including internal audit;
- Embedded monitoring and supervisory controls (not performed by the control operator);
- Pure self-assessment by the control operator supported by quality assurance reviews including internal audit; and
- Pure self-assessment by the control operator.

These reviews may be performed in a business area, at a location or a combination of these.

We also consider that additional assurance can be obtained from the wider activities of internal audit, compliance, operational risk and other quality assurance functions.

**Question 21: What considerations are appropriate to ensure that the guidance is responsive to the special characteristics of entity-level controls and management at smaller public companies? What type of guidance would be useful to small public companies with regard to those areas?**

We do not think that this question is applicable for the members of the Hundred Group.

**Question 22: In situations where management determines that separate evaluation-type testing is necessary, what type of additional guidance to assist management in varying the nature and extent of the evaluation procedures supporting its assessment would be helpful? Would guidance be useful on how risk, materiality, attributes of the controls themselves, and other factors play a role in the judgments about when to use separate evaluations versus relying on ongoing monitoring activities?**

In situations where management determines that separate independent testing is necessary, we request principle-based guidance to aid management's judgement in varying the nature and extent of the evaluation procedures that they should apply. In particular, we consider the guidance currently provided in AS 2 to auditors to be unnecessarily restrictive, forcing both management and the auditors to perform more detailed testing than is considered necessary when adopting a top-down, risk-based approach. We request guidance that covers both "business as usual" activities and activities resulting from business change.

We support the guidance given in paragraph 5 of "Scope of Assessment" in Section C, "Reasonable Assurance, Risk-based Approach and Scope of Testing and Assessment", of the May 16, 2005 Guidance, and request that the Commission reemphasise the ability of management to apply its judgement to adjust the nature, extent and timing of testing from year to year based on its cumulative knowledge and experience, as this appears to be in conflict with the requirements set out in AS 2 and some external auditors' interpretation of those requirements.

**Question 23: Would guidance be useful on the timing of management testing of controls and the need to update evidence and conclusions from prior testing to the assessment “as of” date?**

In situations where management determines that separate independent testing is necessary, we request principle-based guidance to aid management’s judgement in varying the timing of the evaluation procedures that they should apply. In particular, we consider the guidance currently provided in AS 2 to auditors to be unnecessarily restrictive, and it forces both management and the auditors to perform more update testing at the “as of” date than is considered necessary when adopting a top-down, risk-based approach. We request guidance that covers both “business as usual” activities and activities resulting from business change.

**Question 24: What type of guidance would be appropriate regarding the evaluation of identified internal control deficiencies? Are there particular issues in evaluating deficient controls that have only an indirect relationship to a specific financial statement account or disclosure? If so, what are some of the key considerations currently being used when evaluating the control deficiency?**

We are supportive of Section D, “Evaluating Internal Control Deficiencies”, of the May 16, 2005 Guidance on evaluating internal control deficiencies. In particular, management must exercise judgement in assessing deficiencies, as must the auditors apply their professional judgement.

We request principle-based guidance that would aid management’s judgement when assessing the aggregation of potential and/or actual deficiencies and the assessment of the impact of a deficiency in entity-level controls and IT general controls. Additionally, we request acknowledgement that effective entity-level controls can be used as a compensating control to mitigate the failure of a specific transaction level control.

Principle-based guidance that acknowledges the use of professional judgement by the auditor in conjunction with management that is not driven by pure analytical quantitative assessment using “A Framework for Evaluating Control Exceptions and Deficiencies” (version three of December 20, 2004) is requested, including criteria that assist with the judgement of when control deficiencies should be aggregated together.



**Question 25: Would guidance be helpful regarding the definitions of the terms “material weakness” and “significant deficiency”? If so, please explain any issues that should be addressed in the guidance.**

We request principle-based guidance that clarifies and aids the application of management’s judgement to determine what is material in the context of each organisation’s financial statements and disclosures for Section 404 purposes. This guidance should seek to achieve an alignment between the application of management’s judgement on materiality and the professional judgement of the external auditors, which is determined by existing auditing standards. These auditing standards do not reflect the different nature and financial structuring of organisations, and at present recommend a single quantitative assessment to be applied by the auditor. We request that the Commission acknowledge its principle that “one size does not fit all”, not only with respect to each organisation but also within each organisation with respect to both financial statements (including balance sheet reclassifications) and related disclosures.

We also request that the principle-based guidance on materiality set out in the May 16, 2005 Guidance recommending the use of annual and company rather than interim or segment measures be retained, but importantly that these also be the measures applied when identifying and assessing a material weakness.

We further request that the Commission confirm as set out in the May 16, 2005 Guidance that not all the examples included in AS 2 paragraph 140 and appendix D automatically result in a material weakness and that each case must be assessed on its own circumstances, allowing both management and auditors to apply their respective judgements. For example, we do not agree that a significant deficiency that has been communicated to the audit committee and that senior management have consciously chosen (on a cost benefit and/or risk analysis basis) not to remediate should automatically be classified as a material weakness so long as the potential for a material misstatement is regularly reviewed by senior management and reported to the audit committee.

We request that the Commission provide further guidance on the applicability and application of the “prudent official” test contained in paragraph 137 of AS 2, which can result in an overly conservative interpretation of materiality by the external auditor.

**Question 26: Would guidance be useful on factors that management should consider in determining whether management could conclude that no material weakness in internal control over financial reporting exists despite the discovery of a need to correct a financial statement error as part of the financial statement close process? If so, please explain.**

We support the Commission position as set out in the May 16, 2005 Guidance in Section D, "Evaluating Internal Control Deficiencies", and request that the Commission acknowledge that the same assessment should apply to financial reporting errors discovered by the external auditors as part of their review of the financial statements close process.

**Question 27: Would guidance be useful in addressing the circumstances under which a restatement of previously reported financial information would not lead to the conclusion that a material weakness exists in the company's internal control over financial reporting?**

We support the Commission position as set out in the May 16, 2005 Guidance in Section D, "Evaluating Internal Control Deficiencies".

**Question 28: How have companies been able to use technology to gain efficiency in evaluating the effectiveness of internal controls (e.g., by automating the effectiveness testing of automated controls or through benchmarking strategies)?**

We generally have not been able to use technology to gain efficiencies in evaluating the effectiveness of internal control.

Benchmarking of IT application controls is recognised as being an opportunity to achieve efficiencies in the testing of automated controls. Despite guidance issued on May 16, 2005 by the PCAOB, there are inconsistent interpretations by external auditors as to the nature, extent and timing of benchmarking permitted by management and the benefit that will accrue to the current and future evaluations of internal control over financial reporting. We request that the Commission provide principle-based guidance on the reliance that management can place on benchmarking of IT application controls to reduce the nature, extent and timing of testing and the evaluation of internal control over financial reporting.

**Question 29: Is guidance needed to help companies determine which IT general controls should be tested? How are companies determining which IT general controls could impact IT application controls directly related to the preparation of financial statements?**

**Question 30: Has management generally been utilizing proprietary IT frameworks as a guide in conducting the IT portion of their assessments? If so, which frameworks? Which components of those frameworks have been particularly useful? Which components of those frameworks go beyond the objectives of reliable financial reporting?**

*(Combined answer)*

We support the guidance contained in “Information Technology Internal Controls” in Section F, “Information Technology Issues”, in the May 16, 2005 Guidance.

We have generally considered the cut down version of COBIT referred to in footnote 20 of the May 16, 2005 Guidance and have applied management judgement as to the appropriateness of the IT general controls that are applicable to our specific organisations and/or business areas/locations.

**Question 31: Were the levels of documentation performed by management in the initial years of completing the assessment beyond what was needed to identify controls for testing? If so, why (e.g., business reasons, auditor required, or unsure about “key” controls)? Would specific guidance help companies avoid this issue in the future? If so, what factors should be considered?**

**Question 32: What guidance is needed about the form, nature, and extent of documentation that management must maintain as evidence for its assessment of risks to financial reporting and control identification? Are there certain factors to consider in making judgments about the nature and extent of documentation (e.g., entity factors, process, or account complexity factors)? If so, what are they?**

**Question 33: What guidance is needed about the extent of documentation that management must maintain about its evaluation procedures that support its annual assessment of internal control over financial reporting?**

*(Combined answer)*

Yes, documentation levels have been too extensive based on the lack of initial guidance and the interpretation of what is required by management and the auditors, who are dependent on AS 2 and the FAQs issued by the PCAOB and the Commission.

Yes, specific principle-based guidance would be helpful to all registrants to assist them in avoiding unnecessary documentation of risk assessment and scoping, controls, testing of controls and the evaluations and assessment process. Such guidance should assist all registrants to effectively and efficiently embed the documentation and testing of management’s evaluation of internal control over financial reporting.

Currently, the documentation standards imposed on external auditors by Auditing Standard No. 3, “Audit Documentation”, have in turn become a minimum requirement for management’s documentation and testing of controls that the auditors expect to be in place in order for them to place reliance upon the work of management and “others”. This is creating an unnecessary burden on management’s documentary evidence to support their evaluation of internal control over financial reporting, and is not aligned with the business needs or the ability of management to apply judgement using a top-down, risk-based approach as to the documentation standards and evidence that are appropriate to that risk assessment and their organisation.

We request the Commission provide principle-based guidance that aids management’s judgement, using a top-down, risk-based approach, as to the documentation standards and evidence that are appropriate to management’s risk assessment and organisation.

We recognise the requirements placed upon external auditors by existing auditing standards and request that the Commission seek a reduction of the documentation requirements imposed on auditors to enable them to place maximum reliance on the work of management and “others”.

*(Combined answer continued)*

These recommendations would assist in a reduction of unnecessary documentation costs and, where appropriate, increase the reliance that auditors could place on the work of management and “others”, reducing the overall cost of the audit.

We also request that the Commission provide guidance on registrant documentation (and the underlying evidence) retention requirements for Section 404.

**Question 34: Is guidance needed about documentation for information technology controls? If so, is guidance needed for both documentation of the controls and documentation of the testing for the assessment?**

We request the Commission provide principle-based guidance on documentation and testing standards that will aid management's judgement in a top-down, risk-based approach that seeks to place reliance on IT application controls and/or IT dependent controls, recognising the difficulty registrants face with the documentation requirements (base-lining) for legacy systems and the ongoing maintenance of that documentation (to reflect changes to internal control over financial reporting) to support an IT benchmarking testing strategy.



**Question 35: How might guidance be helpful in addressing the flexibility and cost containment needs of smaller public companies? What guidance is appropriate for smaller public companies with regard to documentation?**

We do not think that this question is applicable for the members of the Hundred Group.

## **Other Issues**

We would welcome guidance on the nature, extent and timing of documentation and testing, both pre- and post-“go live” timing, that defines the minimum requirements for management and the auditors to be able to sign off on Section 404 compliance of a significant IT/system implementation and impacted financial controls with less than four months to the end of the year (for example, reliance upon User Acceptance Testing (UAT) and strong change management controls in the IT environment).