

September 20, 2006

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

By E-mail: rule-comments@sec.gov

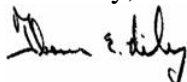
**Re: Securities and Exchange Commission Concept Release [Release No. 34-54122;  
File No. S7-11-06] Concerning Management's Reports on Internal Control Over  
Financial Reporting**

Dear Ms. Morris:

The New York State Society of Certified Public Accountants, representing 30,000 CPAs in public practice, industry, government and education, submits the following comments to you regarding the above captioned Concept Release. NYSSCPA thanks SEC for the opportunity to comment on this release.

The NYSSCPA SEC Practice Committee and the Auditing Standards and Procedures Committee deliberated the Concept Release and jointly drafted the attached comments. If you would like additional discussion with us, please contact Mitchell Mertz, the Chair of the SEC Practice Committee at (212) 891-4048, Robert W. Berliner the Chair of the Auditing Standards and Procedures Committee at (212) 503-8853, or Ernest J. Markezin, NYSSCPA staff, at (212) 719-8303.

Sincerely,



Thomas E. Riley  
President

Attachment



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**NEW YORK STATE SOCIETY OF  
CERTIFIED PUBLIC ACCOUNTANTS**

**COMMENTS TO THE US SECURITIES AND EXCHANGE COMMISSION ON  
SEC CONCEPT RELEASE [RELEASE NO. 34-54122; FILE NO. S7-11-06]  
CONCERNING MANAGEMENT'S REPORTS ON INTERNAL CONTROL  
OVER FINANCIAL REPORTING**

**SEPTEMBER 20, 2006**

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# **New York State Society of Certified Public Accountants**

## **Comments to the US Securities and Exchange Commission on SEC Concept Release [Release No. 34-54122; File No. S7-11-06] Concerning Management's Reports on Internal Control Over Financial Reporting**

**September 20, 2006**

### **General Comments**

We appreciate the opportunity to provide the Commission with comments regarding the issues raised in Concept Release No. 34-54122 "Concerning Management's Reports on Internal Control Over Financial Reporting" (the "Concept Release"). Since the Commission's adoption of rules implementing Section 404(a) of the Sarbanes Oxley Act of 2002 ("Section 404(a)"), and subsequent approval of PCAOB Auditing Standard No. 2 ("AS2"), management of public companies subject to the requirements of these standards have frequently called for clarification and additional guidance to assist them in efficiently and effectively fulfilling their obligations to assess and evaluate internal controls over financial reporting. Therefore we support the Commission's initiative to seek input regarding this much needed guidance.

### **Matters upon Which the Concept Release Requested Specific Comment**

#### **Section II. – Introduction, Question No. 4 and 10**

Under AS2, the Independent Registered Public Accounting Firm ("the independent auditor") is currently required to provide two opinions when reporting on an audit of internal controls over financial reporting. The first opinion addresses management's assessment of a company's internal controls, while the second opinion addresses the effectiveness of the internal controls over financial reporting. We believe, however, that issuing two opinions has created confusion for both the users of financial statements as well as the independent auditor. Therefore, we would support an initiative by the Commission to eliminate the independent auditor's opinion on management's assessment of a company's internal controls because management's assessment is subsumed in the auditor's opinion on internal controls. Removing the requirement to express an opinion on management's assessment of internal control would not only eliminate the confusion created by dual opinions, but would also provide consistency between the independent auditor's reporting on internal control and on financial statements.

If the Commission disagrees with our recommendation to remove the auditor's dual reporting requirement, then the Commission should, at a minimum, provide additional

guidance to clarify the necessary level of assurance that the auditor needs to obtain in order to express an opinion on management's assessment of internal control. We feel that the requirement for the independent auditor to express an opinion on management's assessment of internal control is responsible, in no small part, for the inordinate amount of detailed testing of this process by auditors. In fact, the purpose of the auditor's evaluation of management's process is simply to become satisfied that management has an appropriate basis for their conclusions. Therefore, additional guidance in this area could improve the efficiency of this process.

The Commission should also consider providing specific guidance on the evaluation of control deficiencies. Independent auditors have been pushing management to quantify the dollar effect that such deficiencies have on the financial statements before considering the effect of existing compensating controls. As a result, companies are currently spending excessive time and resources on extrapolating errors in their tests of controls that do not have the potential to result in a material misstatement in the financial statements.

### **Section III. - Risk and Control Identification, Question No. 11, 12, 13, 15 and 17**

We strongly support the Commission's preference for management to employ a top-down risk-based approach when implementing the requirements of Section 404. Our experience indicates, however, that management does not typically understand how to effectively execute such an approach. Part of the problem may stem from the fact that during the initial years of implementation, management took an overly conservative stance toward the requirements of Section 404. Therefore the SEC should develop guidance on how to identify material risks, determine the scope of the assessment, and identify key controls. Such guidance will help management to determine the level of detail involved in the assessment process.

Companies that lack both strong control environments and an appropriate tone at the top are susceptible to misstatements that may not be detected in a timely manner. Therefore, guidance is needed about the role of entity-level controls in evaluating and assessing the effectiveness of internal control over financial reporting. In particular, we think such guidance should address how audit committees can best contribute to a strong control environment.

We also believe that management will benefit from specific guidance on the identification and evaluation of controls to prevent or detect fraud. This is particularly important given the relative high risk of management override in smaller companies.

### **Section V. – Documentation to Support the Assessment, Question No. 32**

We have noted a wide disparity in the nature and extent of documentation that management has provided in support of the assessment of internal controls over financial reporting. Although we do not espouse a "one size fits all" approach to this documentation, we do believe that the Commission should provide some guidelines

regarding the nature and extent of management's documentation. Such documentation should address management's basis for the scope of its assessment, identification of material risks and key controls, and the credentials of those charged with evaluating and testing the controls. Additionally, the proposed guidance should address standards for maintaining and updating this documentation. Such guidance will not only improve the quality and efficiency of management's assessment of internal controls, but will also facilitate the independent auditor's examination.

### **Other Specific Comments**

Although the CEO and CFO are ultimately responsible for reporting on management's assertions regarding internal control, these individuals are often far removed from the actual processes and underlying controls upon which they are reporting. Thus as a matter of practicality, the CEO and CFO frequently rely upon work performed by subordinates when providing the required assertions. Given these circumstances, we believe that the SEC should provide guidance that addresses suggested levels of training, experience, and credentials for those employees charged with evaluating and testing internal controls.