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SEC SEEKS COMMENTS ON APPLICATION OF “SOX” SECTION 404

by
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The Securities and Exchange Commission (“SEC”) rules implementing Section 404 of the Sarbanes-Oxley Act of 2002 require the management of reporting companies to assess internal control over financial reporting and require the auditors of public companies to attest to management’s assessment. On July 11, 2006, the SEC issued a Concept Release “to understand better the extent and nature of public interest in the development of additional guidance for management regarding its evaluation and assessment of internal control over financial reporting so that any guidance the [SEC] develops addresses the needs and concerns of public companies, consistent with the protection of investors.” Release No. 34-54122, <http://www.sec.gov/rules/concept/2006/4-54122.pdf> (July 11, 2006). Various issues and concerns pertaining to the implementation of Section 404 have been brought to the attention of the SEC, chief among which has been the cost burden imposed on reporting companies that have been subject to the rules for the past two years. The SEC also has received feedback relating to both procedural and cost concerns for smaller reporting companies, which have not yet been required to comply with the rules.

The SEC anticipates that the guidance issued would be in the form of a rule that would address the following matters:

- identifying risks to financial statement account and disclosure accuracy and the related internal controls that address the risks, including how management might use company-level controls to address the risks;
- objectives of the evaluation procedures and methods or approaches available to management to gather evidence to support its assessment;
- factors management should consider to determine the nature, timing, and extent of its evaluation procedures; and
- documentation requirements, including overall objectives of the documentation and factors that might influence documentation requirements.

The SEC intends for the guidance to be equally useful to companies of all sizes and applicable to companies’ particular circumstances. Further, the SEC anticipates that if companies followed this rule, they would be deemed to have complied with the rules implementing Section 404.

The SEC seeks public comment on the matters covered in the Concept Release and any additional topics not addressed therein for which guidance would be useful. Because the SEC plans for its forthcoming guidance to be issued in the form of a rule, and because the rule, if adopted, will address the procedures that must be undertaken and impact the costs that must be borne by reporting companies in order to comply with the rules implementing Section 404, which will impact investors in companies of all

sizes, it is important that the SEC receive comments from representatives of all types of reporting companies as well as individual and institutional investors. Comments can be submitted via the Internet or paper submission on or before September 18, 2006.

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