

May 4, 2006

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

RE: File Number 4-511 – Sarbanes-Oxley (“SOX”) Section 404 Internal Control Reporting Requirements

Dear Ms. Morris:

The Institute of Management Accountants (IMA) welcomes the opportunity to provide comments to the U. S. Securities and Exchange Commission regarding the implementation of internal control reporting and auditing provisions under Section 404 of the Sarbanes-Oxley Act of 2002 and the PCAOB Auditing Standard No. 2.

EXECUTIVE SUMMARY

IMA continues to believe that while Sarbanes Oxley legislation has resulted in many benefits to society, the implementation has resulted in dire consequences for corporations large and small and U.S. global competitiveness in general. We believe that more dramatic actions are required and that it is not too late to “get it right” on SOX compliance, especially with regard to Section 404. Specifically, IMA has completed a “first of its kind” root cause survey which reveals that a) current management guidance (in particular COSO 1992) is not “fit for purpose”, b) PCAOB AS2 has become the de facto standard for management guidance as a result of this void, and c) while there are aspirations to develop “top-down/risk-based” assessment approaches, there are significant gaps in implementation including definition of what these terms really mean in practice. Corporate practitioners are saying loud and clear that they require management guidance that is risk-based and practical to allow them to realize the value in their SOX compliance activities. The IMA wishes to work with all interested parties to be part of the solution, and to this end, has proposed a specific framework applicable to organizations of all sizes that is directed to management (CEO, CFO and business process owners) and is top-down and risk-based in terms understandable to management.

OVERVIEW

The IMA is the world's leading association for management accounting and finance professionals dedicated to equipping our members to drive business performance and building quality and accountability from within while controlling unnecessary business costs. Our members play front line senior roles in the financial reporting and analysis process, including designing, maintaining, and reporting on internal controls over financial reporting (ICoFR). The IMA is also one of the five founding members of the Committee of Sponsoring Organizations ("COSO") of the Treadway Commission.

It is important to note that our members believe the Sarbanes-Oxley Act of 2002 in general and Sections 302 and 404 in particular have considerably improved the overall state of corporate governance in their companies. Management reporting and auditor attestation of internal control over financial reporting has certainly resulted in a number of positive benefits for our members such as standardized and improved documentation of their business processes, strengthened the overall control environment (especially "tone at the top"), increased attention and vigilance by the audit committee of the company's financial reporting processes, better whistle blowing and anonymous complaint processes, and increased automation of the control activities with a goal to improve the design and operation of the overall internal control system.

Unfortunately, these tremendous benefits have been realized by our member companies and their stakeholders at such an exorbitant cost that the net result is shareholder value erosion. We all know too well that when Congress passed this landmark legislation, this outcome certainly was not their intent. There is no denying the fact that SOX compliance costs have decreased during year two but not by a huge margin. By some measures, there does not appear to be any change in auditor fees and on a "sustainable basis" many of our members still expect to allocate a large share of their expense budgets to compliance activities. In increasingly global and competitive world markets in which our member organizations compete, even a few basis points of reduction in their operating margins is punished brutally by the international as well as the U.S. capital markets. Thus, it is of paramount importance that we continuously seek ways to comply with the "spirit" of the Sarbanes-Oxley Act of 2002 in the most cost effective manner. We applaud the Commission's efforts to hold these roundtables to listen to the views of various constituents in an effort to continuously improve the implementation of internal control provisions under SOX. The IMA is submitting this letter to share our views and research with the hope that the Commission will consider our comments on these important matters.

THE RESEACH STUDY

The comments included in this letter are being submitted by the IMA's Research Centre of Excellence. After listening to the comments and feedback from our members in the field, the IMA decided to commission a research study to validate some of their concerns about the root causes of the Section 404 implementation mishaps. This research study was undertaken during the first quarter of 2006 by Dr. Parveen P. Gupta, a professor at Lehigh University who researches and teaches in the area of corporate governance and risk management with advice and input from Dr. Sandra Richtermeyer, IMA's Professor-

in-Residence as well as a number of practitioners who “field tested” the survey. The survey was sent to more than 15,000 professionals gleaned from the membership rosters of the IMA and the Institute of Internal Auditors, as well as targeted lists of corporate practitioners. We had over 2000 total respondents and nearly 400 usable responses which resulted in a highly targeted, representative group of CFOs, Controllers, SOX compliance specialists and internal auditors – practitioners who are experiencing the real pain points of SOX every day. The study currently is being “peer reviewed” and will be published by the IMA during the first half of June 2006.

Although our survey covers a wide-range of issues, for the purposes of this comment letter we focus on two key areas which we believe are the real “root cause” of Section 404 implementation mishaps. Thus, our remarks relate directly to the following two questions identified in the Commission’s *Briefing paper Roundtable on Second-Year Experiences with Internal Control reporting and Auditing Provisions*:

Panel 2 Question 3:

Is there sufficient information available to management concerning the appropriate internal control framework? Is there sufficient information available concerning how management should conduct an internal control assessment?

Panel 5 Question 3:

Is there specific additional guidance regarding internal control over financial reporting that the Commission should provide to companies, including guidance with respect to management’s assessment? Is there specific additional guidance that the Board should provide to auditors regarding the audit of internal control?

Based on our members’ experiences and research findings, IMA’s answer to both of these questions is “NO”. Our key research findings are summarized below.

THE ROOT CAUSES OF SOX 404 IMPLEMENTATION MISHAPS

Based on the results of the above mentioned IMA research study, we find that a great deal of implementation challenges and higher cost burdens are primarily driven by the following two factors:

(1) Inability of the COSO 1992 Framework “Internal Control—Integrated Framework” to guide management and the external auditor in arriving at a binary conclusion on the effectiveness of internal control over financial reporting.

We believe that the endorsement of the SEC of the 1992 COSO Internal Control – Integrated Framework (“COSO 1992, in Final Rule: Management’s Reports on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports as appropriate guidance for management to assess the effectiveness of a company’s ICoFR for Section 404) was a “wrong turn” on the path to cost effective SOX compliance. As a founding member of COSO with intimate knowledge of the strengths and weaknesses of the 1992 framework, it is our opinion that, although COSO 1992 was a major breakthrough 14 years ago, it is not “fit for purpose” for cost-effective Section 404 assessments and does not provide the type of “top-down/risk-based” guidance for management now being rightfully called for by the Commission and the PCAOB.

We also believe that COSO 1992 does not actually meet the Commission's own stated acceptance criteria for a suitable assessment framework for Section 404. IMA shared this concern with the COSO Board in September, 2005. Specifically, we do not believe that it meets the stated criteria that it must "permit reasonably consistent qualitative and quantitative measurements of a company's internal control;" and that it "be sufficiently complete so that those relevant factors that would alter a conclusion about the effectiveness of a company's internal controls are not omitted." Again, in terms of providing principles-based guidance which broadly defines "what is good internal control and how do you know when you have it in place", COSO 1992 has stood the test of time. However, in terms of serving as a generally accepted assessment framework FOR MANAGEMENT, it has not kept up with the times in terms of speaking the language of management and providing practical, how to implementation guidance. The language of management is strategic planning, business objectives, performance and risk management – controls in context of inherent and residual risk get at the heart of the questions "how much control is enough" and what are the truly "key" controls.

(2) Management's attempts to use the recently issued PCAOB Auditing Standard No. 2 as the "de facto" control assessment standard in conducting their internal control assessments.

IMA believes that the PCAOB had no choice but to create ICoFR assessment guidance in the form of Auditing Standard No. 2 (AS2) which describes in a more granular way the steps that the PCAOB felt were necessary for management as well as the external auditors to assess ICoFR. Consequently, AS2 became, by default, the de facto management assessment standard for Section 404 compliance because of the lack of assessment guidance specifically tailored to company management, CFOs and business process owners.

Much like FASB sets the accounting standards for registrants to follow while preparing their financial statements and the PCAOB sets the auditing standards to audit that information, we believe that in the internal control assessment area the same distinction should be retained. Thus, the PCAOB should be setting the auditing standard that should guide the external auditor on how to audit the internal control assessment conducted by the company management according to an internal control model that meets the criteria as specified by the Commission in the Section 404 Final Rules. The PCAOB should not be developing the primary guidance for use by company management to assess their internal control over financial reporting. Unfortunately, when an attempt is made to create one standard that addresses the how to of the "management's assessment" as well as the "audit of the management's assessment", it is bound to create confusion with the registrants because they are not able to distinguish between what they should and should not be doing to complete their assessment. It is our belief that, if and when such an internal control assessment standard for management is developed by the Commission it should focus on managing the "inherent" as well as "residual" risk of misleading financial disclosures. The external auditor will rightfully focus on "controls" as they do now but given management's assessment and residual risk profile of their financial reporting process, they will only focus on "key" controls to the exclusion of mind-numbing testing and documentation as it is being currently done.

Interestingly, the lack of a management standard on internal control is clearly revealed in the aforementioned IMA survey: A **resounding 62% of respondents stated that the majority of their internal control assessment was largely guided by and conducted in accordance with PCAOB Auditing Standard No. 2**” as opposed to the COSO 1992 Framework. Managements’ reliance on an auditing standard was further confirmed by the fact that almost 50% of management respondents cited “Lack of a generally accepted assessment criteria/framework” as a primary SOX cost driver. Our review of the recently released draft of the report of the SEC small business advisory committee indicates to us that they share with us in the above mentioned concerns that management guidance does not exist, and as a result, AS2 has become the de facto standard for management’s assessment.

IMA believes that “top-down, risk-based” guidance directed to management does not currently exist for the registrant companies and is urgently needed to “get it right on SOX compliance”.

KEY ROOT CAUSE RESEARCH FINDINGS: No top-down, risk-based guidance for management

Presented below are more granular findings to highlight why AS2 has emerged as the “de facto” guidance for company management for assessing the effectiveness of their ICoFR as a result of COSO 1992 being inappropriately “stretched” to satisfy the demands placed on it by Section 404:

1. About 70% of management respondents indicated that, to a moderate or large extent, that “Lack of practical guidance from the SEC or other professional organizations on how to accomplish the task of deciding what constitutes an “effective” or “ineffective” internal control system was a significant SOX cost driver”.
2. Only 14% of management respondents indicated that they used COSO 1992, to a large extent, prior to SOX and an even smaller 7.5% of internal auditors indicated that they used COSO 1992, to a large extent, in their work prior to passage of SOX legislation. An equally small 8.4% of respondents indicated that their external auditors, to a large extent, utilized COSO 1992 in their work. What this indicated to us is that, although COSO 1992 was over a decade old in 2002 when SOX was enacted, the amount of real acceptance of it as a practical tool by management and auditors had been very small.
3. Only 20% of respondents from medium to large companies and an even smaller 14% of respondents from small companies indicated that their SOX assessment approach was “risk based” when risk based was defined as identification and evaluation of residual risks. Managing residual risk is a key element in controlling the cost of control. One respondent went so far as to state “Auditors will not accept a risk based approach due to lack of understanding and fear of PCAOB”.
4. Less than 50% of respondents said that they identified plausible risks that could threaten the integrity of their account balances. This was even worse for note disclosure where only 30% identified plausible risks that could threaten the integrity of their note disclosures. It is difficult to see how, in the absence of taking the time to identify specific plausible risks that threaten account and note disclosures, a company can claim that their assessment is risk based or, more

- importantly, is in accordance with the Risk Assessment component of COSO 1992.
5. Only 36% of respondents believe, to a large extent, that COSO 1992 is free from bias. We believe the issue here is that COSO 1992 was written by external auditors with an external audit and control viewpoint versus a framework that draws heavily on total quality management and risk management utilized by company management, CFOs and business process owners to optimally drive business performance for shareowners.
 6. Only 34% respondents believe, to a large extent, that COSO 1992 permits reasonably consistent qualitative and quantitative measurements of a company's internal control over financial reporting.
 7. Only 36% of respondents believe, to a large extent, that COSO 1992 is sufficiently complete so that relevant factors that could alter a conclusion on internal control effectiveness was not omitted.
 8. Only 19% of respondents believe, to a large extent, that it is possible using COSO 1992 to achieve a high degree of consensus in conclusions reached by management or auditors on control effectiveness.
 9. Only 5% of management respondents believe, to a large extent, that COSO 1992 provides the necessary top-down/risk based guidance to assess ICoFR for SOX.
 10. Less than 10% of management respondents believe that COSO 1992, to a large extent, provides adequate guidance to support the effective/ineffective conclusion required by SOX. Typical responses include "COSO is very vague and non-specific. Even the training classes in COSO cannot answer the "what to do" questions asked by the auditors", "Subjective items especially in areas such as control environment, where it is difficult to measure, COSO was not a tremendous help".
 11. When asked the degree to which COSO was used to conclude on the effectiveness of controls related to specific account balances, on average, less than 30% of respondents, to a large extent, relied on COSO guidance. The only exception was that approximately 40% relied on COSO guidance in the COSO 1992 Control Activities category, an area that one might think COSO 1992 should be least useful given its original focus as a broad, principles based control framework.
 12. Almost 25% of respondents acknowledged they did not complete an anti-fraud assessment for industry risk factors but apparently believed their assessments were still done "in accordance with COSO 1992". When further analyzed the one in 4 that did not complete industry specific anti-fraud assessment in medium to large companies rose to 34% that skipped this step in small companies.
 13. More than 50% of respondents acknowledged that they did not use COSO 1992 to assess IT control effectiveness in spite of indicating their control assessment was done in accordance with COSO 1992 and not referencing the actual control assessment framework they did use. (i.e., almost 52% of respondents used COBIT for this critical aspect of their ICoFR assessment).
 14. Only 10% of respondents found COSO 1992 useful, to a large extent, in mapping reportable control deficiencies to the COSO 1992 control categories.
 15. In our thorough analysis of PCAOB AS2, IMA has been unable to identify tangible guidance for external auditors describing the steps they should/must take to support an audit opinion that management, in fact, completed their ICoFR "in accordance with COSO 1992". It would seem to us that, by omission, the

PCAOB also has recognized that many companies cannot, and are not, in fact, doing their ICoFR in accordance with COSO 1992. We consider management's claim that their assessment was done in accordance with COSO to be an important core element of their representation, just as a claim that accounting has been done in accordance with U.S. GAAP is a critical piece of information for those relying on and trying to interpret financial statements. The survey results indicate that a more accurate statement from management would be that they have done their ICoFR for SOX in accordance with PCAOB AS2.

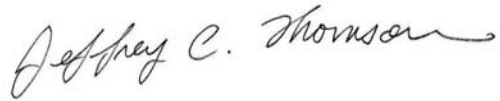
NEXT STEPS TO ADDRESS SOX COMPLIANCE ISSUES: IMA INTENDS TO BE PART OF THE SOLUTION

IMA believes there is an urgent and pressing need for cost-effective ICoFR control assessment guidance that is fully in accord with SEC calls for "top-down/risk-based" control assessments; assessments that are capable of achieving the "spirit of SOX" at a cost that is tolerable in terms of U.S. global competitiveness and enables practitioners to realize the value in compliance. However, with all due respect, IMA believes that to date only incremental solutions have been presented and in many cases, there appears to be an unwillingness to "challenge the status quo". IMA intends to be part of the solution in working with all interested parties to "get it right on SOX compliance". To this end, we have proposed a specific, top-down/risk based framework (directed to company management, CFOs and business process owners) that we truly believe will enable corporations *of all sizes* to realize the value in compliance. This framework includes practical "how to" language and implementation tools and nicely complements the COSO 1992 principles-based approach.

It is our genuine belief that if such guidance was officially approved by the SEC, the PCAOB can get back to doing what it was charged to do—setting auditing standards for external auditors in the area of financial statement audit and internal control audit. The revised AS2 should prescribe the steps that auditors should take to assess whether management has, in fact, assessed controls in a top-down/risk-based manner consistent with the SEC acceptable assessment framework specifically designed and created for registrant management. The focus of the new revised PCAOB AS 2 should be on forming an opinion on the assessment process used by management, not on the external auditors own subjective view of how much control is enough. That is an area that we believe is the responsibility of management. External auditors will still have the ability to design their audit strategies in light of the information on the state of residual risk, signify material weaknesses in management's control system anytime they discover that material adjustments must be made to the accounts or notes prior to the release of the financial statements.

We sincerely hope you find the analysis and suggestions in this letter useful. Please do not hesitate to contact the undersigned if you have any questions or would like to meet to discuss thoughts expressed in this letter.

Yours sincerely,

A handwritten signature in cursive script that reads "Jeffrey C. Thomson". The signature is written in black ink and has a fluid, connected style.

Jeffrey C. Thomson
Vice President, Research and Applications Development
Institute of Management Accountants
201-474-1586 jthomson@imanet.org