



SEC Announces Next Steps for Sarbanes-Oxley Implementation

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Washington, D.C., May 17, 2006 - The Securities and Exchange Commission today announced a series of actions it intends to take to improve the implementation of the Section 404 internal control requirements of the Sarbanes-Oxley Act of 2002.

The actions the Commission intends to take include issuing SEC guidance for companies and working with the Public Company Accounting Oversight Board (PCAOB) on revisions of its internal control auditing standard. These actions are based on extensive analysis and commentary in recent months from investors, companies, auditors, and others. The expected actions will also include SEC inspections of PCAOB efforts to improve Section 404 oversight and a brief further postponement of the Section 404 requirements for the smallest company filers, although ultimately all public companies will be required to comply with the internal control reporting requirements of Section 404.

"The steps we are announcing today are designed to further improve the reliability of financial statements and to better protect investors while making the Section 404 process more efficient and cost effective," said SEC Chairman Christopher Cox. "As we go forward, we will consider the special concerns of all companies that fall under our jurisdiction -- large and small, foreign and domestic. By providing practical guidance to companies, by working with the Public Company Accounting Oversight Board on their forthcoming revised standard for auditors, and by examining how the PCAOB inspection process is succeeding in increasing the efficiency and cost-effectiveness of the audit process, we will take a giant step toward 'getting it right' when it comes to Section 404 compliance."

In recent months, the Commission has obtained comment from a variety of sources concerning the operation and effects of Section 404, including:

- The May 10, 2006, SEC Roundtable on Second-Year Experiences with Internal Control Reporting and Auditing Provisions;
- Written comments received in connection with the Roundtable;
- The April 23, 2006, Report of the SEC Advisory Committee on Smaller Public Companies;
- The April 2006 Report from the U.S. Government Accountability Office entitled *Sarbanes-Oxley Act, Consideration of Key Principles Needed*

in Addressing Implementation for Smaller Public Companies; and

- Feedback from issuers, auditors, investors, and others since the Sarbanes-Oxley internal control reporting requirements went into effect.

"The actions the Commission is announcing today represent key steps toward addressing issues raised by participants involved in the critical process of reporting to investors on the effectiveness of companies' internal control over financial reporting," said John White, Director of the Commission's Division of Corporation Finance. "We will be working on our own, and with the PCAOB, to improve the implementation of Section 404 so that it will work efficiently and effectively for companies and auditors of all sizes and types while still maintaining the important investor protections it provides."

The actions the Commission expects to take include:

- **Guidance for Companies.** The Commission has received many requests for additional guidance for management on how to complete its assessment of internal control over financial reporting, as required by Section 404(a) of the Sarbanes-Oxley Act. To prepare for the issuance of management guidance, the Commission intends to take the following steps:
 - **Concept Release and Opportunity for Public Comment.** The Commission expects to issue a Concept Release covering a variety of issues that might be the subject of Commission guidance for management. With the Concept Release, the Commission will solicit views on the management assessment process to ensure that the guidance the Commission ultimately proposes addresses the needs and concerns of all public companies. We will 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), to assist in our consideration of possible alternatives to the current approach.
 - **Consideration of Additional Guidance from COSO.** The Commission has long been supportive of the Committee of Sponsoring Organizations of the Treadway Commission (COSO) as it works to provide guidance on COSO's 1992 Internal Control - Integrated Framework to address the needs of smaller companies. The Commission anticipates that this forthcoming guidance will help organizations of all sizes to better understand and apply the control framework as it relates to internal control over financial reporting. As the SEC develops guidance for management on how to assess its internal control over financial reporting, we will consider the extent to which the additional guidance that COSO provides is useful to smaller public companies in completing their Section 404(a) assessments.
 - **Issuance of Guidance.** Commentary submitted to the Commission has suggested that management assessments

under Section 404 have not fully reflected the top-down, risk-based approach the Commission intended. Building from the information gathered in response to the Concept Release, and from the anticipated COSO guidance, the Commission currently anticipates that it will issue guidance to management to assist in its performance of a top-down, risk-based assessment of internal control over financial reporting. To ensure that this guidance is of help to non-accelerated filers and smaller public companies, the Commission intends that this future guidance will be scalable and responsive to their individual circumstances. The guidance will also be sensitive to the fact that many companies have already invested substantial resources to establish and document programs and procedures to perform their assessments over the last few years. The form of the guidance has yet to be determined.

- **Revisions to Auditing Standard No. 2.** The PCAOB announced today that it intends to propose revisions to its Auditing Standard No. 2, An Audit of Internal Control Over Financial Reporting Performed in Conjunction with an Audit of Financial Statements. Any final revision of AS No. 2 would be subject to SEC approval. The proposed revisions would:
 - Seek to ensure that auditors focus during integrated audits on areas that pose higher risk of fraud or material error;
 - Incorporate key concepts contained in the guidance issued by the PCAOB on May 16, 2005; and
 - Revisit and clarify what, if any, role the auditor should play in evaluating the company's process of assessing internal control effectiveness.

The Commission will work closely with the PCAOB to ensure that the proposed revisions to AS No. 2 are in the public interest and consistent with the protection of investors.

- **SEC Oversight of PCAOB Inspection Program.** The PCAOB announced on May 1, 2006, that it would focus its 2006 inspections on whether auditors have achieved cost-saving efficiencies in the audits they have performed under AS No. 2, and on whether auditors have followed the guidance that the PCAOB issued in May and November 2005 urging them to do so. As part of the Commission's oversight of the PCAOB, the Commission staff inspects aspects of the PCAOB's operations, including its inspection program. Among other things, upon completion of the PCAOB's 2006 inspections, the staff will examine whether the PCAOB inspections of audit firms have been effective in encouraging implementation of the principles outlined in the PCAOB's May 1, 2006, statement.
- **Extension of Compliance for Non-Accelerated Filers.** In order to permit non-accelerated filers and their auditors to have the benefit of the management guidance that the SEC intends to issue, and to have the opportunity to evaluate and implement the revisions that the PCAOB plans to make to AS No. 2, the Commission expects to issue a

short postponement of the effective date of the Commission's rules implementing Section 404 for non-accelerated filers. It is anticipated that any such postponement would nonetheless require all filers to comply with the management assessment required by Section 404(a) of Sarbanes-Oxley for fiscal years beginning on or after Dec. 16, 2006.

The Commission is also taking this opportunity to express again its appreciation to its Advisory Committee on Smaller Public Companies for their significant efforts and valuable contributions to the Commission's work, both with regard to Section 404 and other issues affecting smaller companies.

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