

SEC FLASH REPORT

SEC Schedules Open Meeting to Discuss PCAOB'S Proposed Auditing Standard and SEC'S Management Guidance for Section 404 of Sarbanes-Oxley Act

March 29, 2007

The Securities and Exchange Commission (SEC) announced today that it will hold an open meeting on April 4, 2007, to accomplish two objectives. First, the Commission will discuss the Public Company Accounting Oversight Board's (PCAOB) proposed auditing standard for complying with Section 404(b) of the Sarbanes-Oxley Act. Second, the SEC will discuss how the PCAOB's proposed standard should be coordinated with the Commission's pending proposal to provide interpretive guidance for management of public companies implementing Section 404. Both proposals were published for public comment in December 2006. The comment periods for both proposals expired on Feb. 26, 2007.

The open meeting represents a continuation of the process announced in May 2006 by the Commission and the PCAOB to improve the reliability of financial statements filed with the Commission under the 1934 Exchange Act, while also making compliance with Section 404 more efficient and cost effective. The SEC's press release quotes Chairman Christopher Cox as stating that "the SEC and the PCAOB have been working together to improve Section 404 procedures to establish a risk-based, top-down approach that is scalable for companies of all sizes." Chairman Cox also pointed out that this meeting will "help to keep us on track to consider final adoption of our management guidance in May 2007."

As part of this process, the Commission has proposed management guidance for Section 404 compliance designed to focus attention on the key controls that mitigate the significant risks of a material financial misstatement. Simultaneously, as a companion to the proposed SEC guidance, the PCAOB has proposed a revision of its existing standard for an audit of internal control over financial reporting in accordance with Section 404. Since the SEC's proposed guidance to management and the PCAOB's proposed standard to the auditor address common decision points along the Section 404 evaluation process, where both management and the auditor must make similar decisions, it makes sense that the two agencies focus on coordinating their efforts and look for opportunities to align their guidance providing criteria regarding these decision points.

The comment letters received by the SEC and the PCAOB have highlighted the importance of alignment between the Commission's and the PCAOB's proposals and have surfaced common issues that both agencies must address to finalize their respective pronouncements. For example, one issue raised was that the proposed auditing standard provides different, and sometimes more granular, guidance than the proposed management guidance in certain areas. While the differences are often subtle, they cause some to question whether they could cause disconnects between the company's assessment and the auditor's assessment. For example, the proposed auditing standard includes a list of specific factors to consider when selecting significant financial reporting elements and the proposed SEC guidance does not. The proposed auditing standard lists factors affecting the risk associated with a control that has different elements than the factors included in the SEC guidance for evaluating control failure risk. The list of strong indicators of

material weaknesses are not presented in a similar manner in the two documents. These and other examples have caused some commenters to suggest that the SEC and PCAOB adopt similar guidance around specific decision points along the Section 404 evaluation process.

At the open meeting, the Commission's staff will describe the remaining issues in aligning the proposed approaches, and those issues will then be considered by the Commission. This issues summary, as well as the ensuing discussion, will provide interested parties with insights as to the direction the two agencies will take in finalizing their respective pronouncements. The open meeting may also provide insights as to the expected timing on the release of the pronouncements. Accordingly, Protiviti will monitor this meeting and provide an update in a subsequent Flash Report covering the points discussed.