



## Alert

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## SEC Plans on Section 404 Reporting

Management assessments of internal control over financial reporting will be subject to new SEC guidance, one of several steps the SEC plans to take to improve the efficiency of the Sarbanes-Oxley Section 404 process, according to a recent public announcement.<sup>1</sup> The SEC expects to provide a short postponement of the implementation date for non-accelerated filers, but nevertheless anticipates requiring all filers to comply with the internal-control assessment requirements for fiscal years beginning on or after December 16, 2006. In a related action, the PCAOB announced a plan to improve auditors' implementation of the requirements for audits of internal control over financial reporting.<sup>2</sup>

### Guidance for Companies

In developing guidance for management assessments of internal control over financial reporting, the SEC intends to incorporate insights from responses to a yet-to-be-issued Concept Release and from the guidance for smaller companies on management assessments expected soon from the Committee of Sponsoring Organizations of the Treadway Commission, also known as COSO.

Based on commentary already obtained, the SEC anticipates that its guidance will assist management in performing a "top-down, risk-based assessment." The commentary suggested that management assessments have not "fully reflected" that approach, which the public announcement says is the approach the Commission had intended. The announced plan calls for guidance that is scalable for smaller public companies and sensitive to the processes that many companies already have in place for assessing internal control.

<sup>1</sup> SEC press release 2006-75, May 17, 2006, "SEC Announces Next Steps for Sarbanes Oxley Implementation," available at <http://www.sec.gov/news/press/2006/2006-75.htm>.

<sup>2</sup> PCAOB press release, May 17, 2006, "Board Announces Four-Point Plan to Improve Implementation of Internal Control Reporting Requirements," available at [http://www.pcaobus.org/News\\_and\\_Events/News/2006/05-17.aspx](http://www.pcaobus.org/News_and_Events/News/2006/05-17.aspx).



### Working with the PCAOB

Part of the SEC's program to make compliance with Section 404 more efficient is to work closely with the PCAOB in its effort to improve auditors' implementation of PCAOB requirements for audits of internal control over financial reporting.

The PCAOB's program, announced the same day as the SEC's, includes amending Auditing Standard No. 2 and reinforcing auditor efficiency through PCAOB inspections. The SEC staff will examine whether the PCAOB's 2006 inspections have been effective in encouraging auditor efficiency.

The PCAOB's amendment to Auditing Standard No. 2 will be intended to ensure that auditors focus on areas that pose a higher risk of fraud or material error. The project will include revisiting the auditor's role in evaluating management's assessment process. It will consider clarifications or additional guidance regarding the following elements of the standard on audits of internal control over financial reporting: the definitions of significant deficiency and material weakness in internal control, materiality and scoping decisions, integrating the internal-control and financial-statement audits, applying prior year's experience, using work by other parties, and evaluating potential deficiencies. The PCAOB intends to establish an effective date for the amendment that minimizes disruption to audits that are in process.

The PCAOB's program also includes developing implementation guidance for auditors of small companies or facilitating the development of that guidance. The PCAOB will continue to hold forums on auditing in the small-business environment for financial officers, directors, and auditors of smaller public companies.

### Effective Dates

The SEC's announcement said it expects to grant non-accelerated filers "a short postponement" of the effective date for implementing the SEC's rules on Section 404 reporting. However, it expects that all filers would be required to comply with the management-assessment requirement for fiscal years *beginning* on or after December 16, 2006. The current deadline for non-accelerated filers is the first fiscal year *ending* on or after July 15, 2007. The SEC's announcement said that the Concept Release will solicit comments on the manner in which independent auditors provide the attestation required by Section 404(b) of Sarbanes-Oxley, but it said nothing about the effective date for auditor reporting. It also said nothing to indicate that the SEC would postpone the effective date for foreign private issuers that are accelerated filers, which is the first fiscal year ending on or after July 15, 2006.

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