

report that the company is required to file under the Exchange Act. The company's certifying officers already are required to evaluate the effectiveness of the company's disclosure controls and procedures on a quarterly basis.<sup>80</sup> We noted that a quarterly evaluation requirement with respect to internal controls would create symmetry between our requirements for periodic evaluations of both the company's disclosure controls and procedures and its internal controls and procedures for financial reporting, and give effect to the language in the Section 302 certification requirements regarding quarterly internal control evaluations.

## 2. Comments on the Proposal

We received responses from 25 commenters on the proposed amendments. Of the 25 commenters, four supported the proposal to require quarterly evaluations of internal controls and procedures for financial reporting.<sup>81</sup> One commenter specifically concurred with our objective of creating symmetry between the requirements to conduct periodic evaluations of both the company's disclosure controls and procedures and its internal controls and procedures for financial reporting.<sup>82</sup>

Twenty-one commenters opposed quarterly evaluations of internal controls.<sup>83</sup> Many of these believed that quarterly evaluations would impose substantial additional costs on companies without producing any incremental benefit to investors. One individual stated that the proper evaluation of a company's system of internal controls is a weighty and time-consuming process.<sup>84</sup> Twelve of the commenters opposed to quarterly evaluations indicated that quarterly evaluations of all aspects of internal controls and procedures would be extremely burdensome, expensive and difficult to perform under the time constraints of quarterly reporting,

particularly as the accelerated filing deadlines for quarterly reports take effect.<sup>85</sup> Several other commenters argued that we should not go beyond the requirements of Section 404 of the Sarbanes-Oxley Act with respect to the frequency of internal control reporting without an adequate basis for doing so.<sup>86</sup> These commenters remarked that such a decision would be better made after we have had sufficient experience with the Section 302 certification requirements adopted in August of 2002.

Several commenters suggested alternatives to quarterly evaluations. Five commenters stated that it would be more appropriate and desirable if companies were required to make quarterly disclosure only of material changes to their internal control that occurred subsequent to management's most recent annual internal control evaluation.<sup>87</sup> Two other commenters similarly recommended that the quarterly evaluation be less rigorous than the annual evaluation.<sup>88</sup> One commenter stated that we should instead adopt an approach that requires less effort and assurance for purposes of quarterly reports, such as permitting companies to test compliance with controls relating to major applications on a rotating basis throughout the year.<sup>89</sup> This commenter further stated that the objective of the quarterly evaluation should be to identify changes in controls during the quarter and evaluate whether they would change the certifying officers' conclusions about disclosure controls and internal controls as stated in the most recent annual report. The other commenter, although opposed to any quarterly evaluation requirement, believed that if we did require it, the quarterly evaluation should be viewed as an update of the annual evaluation, just as the quarterly report on Form 10-Q is an update of the annual report on Form 10-K.<sup>90</sup> One commenter stated that if we require some form of quarterly certification, it should be limited to negative assurance that nothing has come to the certifying officers' attention since the prior year's

evaluation to suggest that the controls are no longer effective.<sup>91</sup>

## 3. Final Rules

After consideration of the comments received, we have decided not to require quarterly evaluations of internal control over financial reporting that are as extensive as the annual evaluation. We recognize that some controls operate continuously while others operate only at certain times, such as the end of the fiscal year. We believe that each company should be afforded the flexibility to design its system of internal control over financial reporting to fit its particular circumstances. The management of each company should perform evaluations of the design and operation of the company's entire system of internal control over financial reporting over a period of time that is adequate for it to determine whether, as of the end of the company's fiscal year, the design and operation of the company's internal control over financial reporting are effective.

Accordingly, we are adopting amendments that require a company's management, with the participation of the principal executive and financial officers, to evaluate any change in the company's internal control over financial reporting that occurred during a fiscal quarter that has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting. We also have adopted a modification to the Section 302 certification requirement and our disclosure requirements to adopt this approach, as discussed below.

The management of a foreign private issuer that has Exchange Act reporting obligations must also, like its domestic counterparts, report any material changes to the issuer's internal control over financial reporting. However, because foreign private issuers are not required to file quarterly reports under Section 13(a) or 15(d) of the Exchange Act, the final rules clarify that a foreign private issuer's management need only disclose in the issuer's annual report the material changes to its internal control over financial reporting that have occurred in the period covered by the annual report.<sup>92</sup>

## *D. Differences Between Internal Control Over Financial Reporting and Disclosure Controls and Procedures*

Many of the commenters on the Proposing Release indicated that they

<sup>80</sup> See Exchange Act Rules 13a-15(b) and 15d-15(b) [17 CFR 240.13a-15(b) and 240.15d-15(b)].

<sup>81</sup> See letters regarding File No. S7-40-02 of: AICPA; Executive Responsibility; FED; and Protiviti.

<sup>82</sup> See Protiviti letter regarding File No. S7-40-02.

<sup>83</sup> See letters regarding File No. S7-40-02 of: ABA; ACB; ACCA; Association for Financial Professionals ("AFP"); Am. Bankers Assoc.; BDO; Business Roundtable ("BRT"); Computer Sciences Corporation ("CSC"); Compass; Thomas Damman ("Damman"); EEI; Emerson Electric Co. ("Emerson"); FEI; Fried, Frank, Harris, Shriver and Jacobson ("Fried Frank"); International Paper Company ("IPC"); ICBA; NYCB-CCL; New York State Bar Association ("NYSBA"); Siemens AG ("Siemens"); Software & Information Industry Association ("SIIA"); and Software Finance and Tax Executives Council ("SOFTEC").

<sup>84</sup> See Damman letter regarding File No. S7-40-02.

<sup>85</sup> See letters regarding File No. S7-40-02 of: ABA; ACB; ACCA; BRT; CSC; Emerson; Fried Frank; ICBA; IPC; NYCB-CCL; SIIA; and SOFTEC.

<sup>86</sup> See letters regarding File No. S7-40-02 of: Am. Bankers Assoc.; CSC; Fried Frank.

<sup>87</sup> See letters regarding File No. S7-40-02 of: Damman; Compass; EEI; Executive Responsibility Advisors, LLC ("Executive Responsibility"); and Siemens.

<sup>88</sup> See letters regarding File No. S7-40-02 of: ABA and BDO.

<sup>89</sup> See BDO letter regarding File No. S7-40-02.

<sup>90</sup> See ABA letter regarding File No. S7-40-02.

<sup>91</sup> See Emerson letter regarding File No. S7-40-02.

<sup>92</sup> See Exchange Act Rules 13a-15(d) and 15d-15(d) [17 CFR 240.13a-15(d) and 240.15d-15(d)].