

were confused as to the differences between a company's disclosure controls and procedures and a company's internal control over financial reporting. Exchange Act Rule 13a-15(d) defines "disclosure controls and procedures" to mean controls and procedures of a company that are designed to ensure that information required to be disclosed by the company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms. The definition further states that disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that the information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

While there is substantial overlap between a company's disclosure controls and procedures and its internal control over financial reporting, there are both some elements of disclosure controls and procedures that are not subsumed by internal control over financial reporting and some elements of internal control that are not subsumed by the definition of disclosure controls and procedures.

With respect to the latter point, clearly, the broad COSO description of internal control, which includes the efficiency and effectiveness of a company's operations and the company's compliance with laws and regulations (not restricted to the federal securities laws), would not be wholly subsumed within the definition of disclosure controls and procedures. A number of commenters suggested that the narrower concept of internal control, involving internal control over financial reporting, is a subset of a company's disclosure controls and procedures, given that the maintenance of reliable financial reporting is a prerequisite to a company's ability to submit or file complete disclosure in its Exchange Act reports on a timely basis. This suggestion focuses on the fact that the elements of internal control over financial reporting requiring a company to have a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting

principles can be viewed as a subset of disclosure controls and procedures.

We agree that some components of internal control over financial reporting will be included in disclosure controls and procedures for all companies. In particular, disclosure controls and procedures will include those components of internal control over financial reporting that provide reasonable assurances that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles. However, in designing their disclosure controls and procedures, companies can be expected to make judgments regarding the processes on which they will rely to meet applicable requirements. In doing so, some companies might design their disclosure controls and procedures so that certain components of internal control over financial reporting pertaining to the accurate recording of transactions and disposition of assets or to the safeguarding of assets are not included. For example, a company might have developed internal control over financial reporting that includes as a component of safeguarding of assets dual signature requirements or limitations on signature authority on checks. That company could nonetheless determine that this component is not part of disclosure controls and procedures. We therefore believe that while there is substantial overlap between internal control over financial reporting and disclosure controls and procedures, many companies will design their disclosure controls and procedures so that they do not include all components of internal control over financial reporting.

E. Evaluation of Disclosure Controls and Procedures

The rules in place starting in August 2002 requiring quarterly evaluations of disclosure controls and procedures and disclosure of the conclusions regarding effectiveness of disclosure controls and procedures have not been substantively changed since their adoption, including in the rules that we adopt today. These evaluation and disclosure requirements will continue to apply to disclosure controls and procedures, including the elements of internal control over financial reporting that are subsumed within disclosure controls and procedures.

With respect to evaluations of disclosure controls and procedures, companies must, under our rules and consistent with the Sarbanes-Oxley Act, evaluate the effectiveness of those controls and procedures on a quarterly

basis. While the evaluation is of effectiveness overall, a company's management has the ability to make judgments (and it is responsible for its judgments) that evaluations, particularly quarterly evaluations, should focus on developments since the most recent evaluation, areas of weakness or continuing concern or other aspects of disclosure controls and procedures that merit attention. Finally, the nature of the quarterly evaluations of those components of internal control over financial reporting that are subsumed within disclosure controls and procedures should be informed by the purposes of disclosure controls and procedures.⁹³

The rules adopted in August 2002 required the management of an Exchange Act reporting foreign private issuer to evaluate and disclose conclusions regarding the effectiveness of the issuer's disclosure controls and procedures only in its annual report and not on a quarterly basis. The primary reason for this treatment is because foreign private issuers are not subject to mandated quarterly reporting requirements under the Exchange Act. The rules adopted today continue this treatment.⁹⁴

F. Periodic Disclosure About the Certifying Officers' Evaluation of the Company's Disclosure Controls and Procedures and Disclosure About Changes to its Internal Control Over Financial Reporting

1. Existing Disclosure Requirements

The rules that we adopted in August 2002 to implement the certification requirements of Section 302 of the Sarbanes-Oxley Act included new Item 307 of Regulations S-B and S-K. Paragraph (a) of Item 307 requires companies, in their quarterly and annual reports, to disclose the conclusions of the company's principal executive and financial officers (or persons performing similar functions) about the effectiveness of the company's disclosure controls and procedures as of a date within 90 days of the filing date of the quarterly or annual report. This disclosure enables the certifying officers to satisfy the representation made in

⁹³ For example, where a component of internal control over financial reporting is subsumed within disclosure controls and procedures, even where systems testing of that component would clearly be required as part of the annual evaluation of internal control over financial reporting, management could make a different determination of the appropriate nature of the evaluation of that component for purposes of a quarterly evaluation of disclosure controls and procedures.

⁹⁴ See Exchange Act Rules 13a-15(b) and 15d-15(b).