THE NASDAQ STOCK MARKET
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Nancy M. Morris
Secretary
U.S. Securities and Exchange Commission
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rule-comments@sec.gov

Laura Phillips
Deputy Chief Auditor
PCAOB
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Re: SEC Proposed Rule Concerning Management's Report on Internal Control over Financial Reporting – Release Nos. 33-8762; 34-54976 (File No. S7-24-06); and

PCAOB Proposed Audit Standard – An Audit of Internal Control over Financial Reporting that is Integrated with an Audit of Financial Statements and Related Other Proposals -- Release No. 2006-007 (Rulemaking Docket No. 021).

Dear Ms. Morris and Ms. Phillips:

The Nasdaq Stock Market, Inc. ("NASDAQ") appreciates the opportunity to respond to the Securities and Exchange Commission's (the "Commission" or "SEC") Proposed Rule Concerning Management's Report on Internal Control over Financial Reporting and the Public Company Accounting Oversight Board's ("PCAOB") Proposed Auditing Standard Regarding an Audit of Internal Control over Financial Reporting that is Integrated with an Audit of Financial Statements. NASDAQ's perspective on these issues is informed by its status both as the operator of a venue for companies to raise capital in the public markets and as an accelerated filer that has been subject to the internal control reporting provisions of the Sarbanes-Oxley Act ("SOX") for the past three years.

SOX's central purpose of restoring confidence in the public markets has been a resounding success. SOX has brought heightened attention to the quality of financial reporting on the part of management and their outside auditors. At the same time, however, the excessively high costs of implementing Section 404 have placed the U.S. capital markets at a competitive disadvantage. These costs are associated with the level of documentation that has been required by outside auditors, the due diligence underlying the required auditor attestation, and the overly broad scope of internal controls subject to the legislation's reporting requirements.

Accordingly, our suggestions are directed at better leveraging the beneficial elements and making changes to lessen the cost of elements of SOX that generate fewer benefits.

It is our opinion that the current and proposed guidance, while beneficial in many respects, still does not address some of the more costly aspects of SOX compliance. Specifically, we are concerned about: (i) the inconsistency and apparent conflict between guidance issued by the SEC to management and guidance issued by the PCAOB to the auditors; (ii) the redundancy between management and independent auditor activities; (iii) the lack of clarity about the scope of evidentiary proof requirements; and, (iv) the lack of clarity about the evaluation of general technology controls. We believe that these are the four major drivers of excessive costs.

The corporate control landscape has changed dramatically over the last three years as public auditors have focused on audit services as their core product, management has accepted through their attestations that good control is good business and the PCAOB has provided oversight of public auditors. Given these profound structural changes it is our opinion that elimination of unnecessary costs is long overdue. Our recommendations to minimize these unnecessary costs follow.

The proposals need to resolve inconsistent guidance between the SEC and PCAOB. Neither the SEC nor the PCAOB guidance 'sets the bar' as to an expected level of review by auditors. In the absence of explicit direction to the contrary, this lack of clarity will certainly lead auditors to take too expansive a scope in their reviews and provides no incentive for auditors to adopt a scalable approach and rely on an integrated audit to reduce costs. In addition, the PCAOB proposal introduces a concept of a "small but complex" company that is not found in the SEC guidance. The subjective determination about complexity could lead an auditor not to appropriately scale its reviews.

Another area where the guidance is in conflict relates to the use of a risk-based approach. The SEC guidance promotes a risk based approach and the use of evidence obtained from on-going monitoring and self-assessment for evaluation of controls in lower risk areas. The PCAOB guidance encourages reliance on the work of others but identifies objectivity as a requirement for this reliance. The SEC and PCAOB guidance seem to be in conflict in this regard. We believe the best method of achieving the intent of the proposals is not only to describe the principles of an acceptable control program but also to provide instructions to the auditor with specific guidance on how to assess the effectiveness of these principles. Without further clarity in the guidance to independent auditors, a proactive self-assessment program instituted by management might result in increased auditor's fees due to the auditor's perceived inability to rely on the work performed by management.

The focus of the independent auditor's opinion should be on evaluating the effectiveness of management's program rather than the effectiveness of individual internal controls. Management should continue to be held accountable for the accuracy of their financial statements and the effectiveness of their associated internal controls. The current proposal, however, removes the need for an independent auditor opinion on the execution of management's program rather than removing the opinion on internal controls. This provides minimal relief, as we believe the primary driver of auditor fees is the opinion on internal controls. The auditor needs to be refocused toward seeing the forest (management's program effectiveness) rather than the trees (individual controls). A successful model in how to achieve this is the FDIC Improvement Act program that applies to FDIC insured banks. This legislation achieved improved controls at banks in a more cost effective fashion, because the FDIC deployed a program effectiveness assessment, in contrast to the current extensive process control testing strategy imposed on public companies.

The proposals should clarify requirements for evidentiary documentation of controls and proof that they are working effectively. The amount, form and medium of documentation should be consistent, reasonable and clear. For example, the proposed requirement for walkthroughs has been modified to apply to significant processes only, but the guidance continues to require the auditor to prescribe the sufficiency of staff performing the walkthrough and to have oversight of the activities. This allows the auditor to dictate the level of detail to be performed and may add a layer of redundancy with regards to testing after the walkthrough. Other areas of ambiguity include the recommendation that higher risk areas require more evidence and lower risk areas less evidence; the recommendation does not, however, clarify what "less evidence" entails. Describing case studies that serve to set the bar for companies and independent accountants would be helpful in resolving discrepancies in documentation between the companies and the independent auditors.

The proposals should clarify the evaluation of general technology controls. The breadth and depth of general technology controls appropriate to address the risk of a material misstatement has not been sufficiently articulated. Subjectivity and lack of clarity has led to increasing levels of annual testing to prove that the general technology controls are adequate. Although both the SEC and PCAOB are advocates of automated controls, lack of clarity is negating the efficiency of choosing automated rather than manual controls, and inhibiting progress in relying on these controls.

Finally, we believe that it is also important for the PCAOB to discipline auditors when they fail to take advantage of appropriate opportunities to reduce testing and other redundant activities, thereby minimizing the costs involved with their review, and for the PCAOB to provide transparency to these actions. This would send a clear message that over-auditing of internal controls is inconsistent with the concepts discussed above, and would make the revised standards meaningful.

We appreciate the opportunity to contribute to the proposed recommendations. Please contact me at (212) 401-8744 if you have any questions.

Very truly yours,

Brian O'Malley

Brian G. O'Malley
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