CHAPTER 10

Disclosure of Internal Control over Financial Reporting

John J. Huber and Joel H. Trotter

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CHAPTER 10

Disclosure of Internal Control over Financial Reporting

John J. Huber and Joel H. Trotter *

INTRODUCTION

This Chapter contains annotated forms for disclosure regarding internal control over financial reporting for periodic reports under the Securities Exchange Act of 1934 (the “Exchange Act”) and registration statements under the Securities Act of 1933 (the “Securities Act”). Disclosure in this area can be viewed as the canary in the mineshaft for a reporting company’s financial statements. As of September 2005, nearly 15% of accelerated filers had a material weakness in internal control over financial reporting, according to a Big Four study. Although not all material weaknesses are created equal, disclosure of a material weakness can portend a restatement of the company’s financial statements or notification of non-reliance on previously issued financial statements under Item 4.02 of a Current Report on Form 8-K. Glass, Lewis & Co. estimates that 1,200 accounting restatements by reporting companies occurred in 2005. Over the same period, reporting companies made approximately 1,250 filings under Item 4.02 of Form 8-K.

In differentiating between types of material weaknesses, Moody’s categorizes material weaknesses as company-level control problems, which auditors cannot audit around, or specific transaction-level processes, which auditors can audit around. Similarly, Institutional Shareholder Services (“ISS”) advises investors to evaluate a material weakness by considering whether the material weakness involves the tone at the top, fraud, or relates to an ongoing investigation, and other characteristics of the material weakness, such as duration, pervasiveness, and whether the company has a history of restatements.

Disclosure in this area combines prescribed standard elements with highly customized, fact-specific components that depend on the nature of the material weakness. The annotated forms in this Chapter provide each of these standard elements as well as a framework for the practitioner to draft the customized, fact-specific components. The forms are not intended for use as fill-in-the-blank documents but rather as a guide to provide disclosure that satisfies several needs:

- compliance with applicable rules of the Securities and Exchange Commission (the “Commission”);
- reduction of potential liability for a registrant’s chief executive officer and chief financial officer, who personally certify to the accuracy of the periodic reports including disclosure of internal control over financial reporting, as well as the registrant itself;
- avoidance of potential issues under Regulation FD by providing complete public disclosure in the periodic report; and
• disclosure to the marketplace demonstrating that the registrant has its arms around the problem and has a plan and a timetable to fix it.

Under Section 404 of the Sarbanes-Oxley Act of 2002 (“Sarbanes-Oxley”) and related rules of the Commission (which currently apply to all accelerated filers and which will apply to non-accelerated filers in 2007), public company annual reports on Form 10-K must include disclosure under Item 9A in which:

• management states its responsibility for establishing and maintaining internal control over financial reporting and identifies the framework used to evaluate the effectiveness of internal control over financial reporting;
• management assesses the effectiveness, as of the end of the fiscal year covered by the report, of the issuer’s disclosure controls and procedures and its internal control over financial reporting; and
• the independent auditor attests to management’s assessment regarding internal control over financial reporting by providing an opinion in accordance with Auditing Standard No. 2 of the Public Company Accounting Oversight Board (“PCAOB”).

In addition, quarterly reports on Form 10-Q must include disclosure under Item 4 regarding:

• management’s evaluation of the effectiveness, as of the end of each fiscal quarter, of the issuer’s disclosure controls and procedures; and
• any material changes that occurred during the fiscal quarter covered by the report with respect to the issuer’s internal control over financial reporting.

Under the Commission’s rules implementing Section 404:

• disclosure controls and procedures refer to controls and other procedures designed to ensure that information required to be disclosed in the reports the issuer files or submits under the Exchange Act is recorded, processed, summarized, and reported, within the time periods specified in the rules and forms of the Commission, including, without limitation, controls and procedures designed to ensure that information required to be disclosed by the issuer in the reports filed or submitted under the Exchange Act is accumulated and communicated to management, including the issuer’s chief executive officer and chief financial officer, as appropriate to allow timely decisions regarding required disclosure; and
• internal control over financial reporting refers to a process designed by, or under the supervision of, an issuer’s chief executive officer and chief financial officer and effected by its board of directors, management, and other personnel, 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 and includes those policies and procedures that:
pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the issuer’s assets;

provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that the issuer’s receipts and expenditures are being made only in accordance with authorizations of its management and members of its board of directors; and

provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the issuer’s assets that could have a material effect on its financial statements.

There is substantial overlap between disclosure controls and procedures and internal control over financial reporting. On the one hand, disclosure controls and procedures include the components of internal control over financial reporting that provide reasonable assurance that transactions are recorded in accordance with GAAP. On the other hand, some registrants may design their disclosure controls and procedures so that certain components of internal control over financial reporting—such as controls relating to the safeguarding or disposition of assets—are not included within disclosure controls and procedures.

Given the substantial overlap between disclosure controls and procedures and internal control over financial reporting, all of these procedural requirements are linked. For example, a material weakness in internal control over financial reporting affects management’s report on internal control over financial reporting and the independent auditor’s Section 404 audit, which in turn can affect management’s evaluation of and conclusions concerning disclosure controls and procedures and the certifications of the registrant’s chief executive officer and chief financial officer under Sections 302 and 906 (subjecting the certifying officers to criminal liability for false certification), as well as the disclosure required under Items 307 and 308 of Regulation S-K. Practitioners need to understand the disclosure requirements and other rules applicable to internal control over financial reporting because individual liability attaches to a false certification by a chief executive officer or a chief financial officer and corporate liability attaches to materially misleading disclosure, both of which could provide a basis for litigation by the Commission as well as private plaintiffs.

Although it may seem counterintuitive, disclosure in a periodic report regarding internal control over financial reporting can actually benefit the registrant. Comprehensive disclosure of what we call the five Ws and an H—what the problem is, where it arises, when it occurred, why it arose, who found it, and how it will be fixed—helps place the material weakness into perspective. Disclosure that places the issue into the proper context can assist the reader in understanding the relatively limited magnitude of an internal control issue. In addition, disclosure demonstrates to the market that management understands the issue and has adopted a plan and a timetable to remedy the material weakness.
These disclosure requirements did not exist before Sarbanes-Oxley. In this new area of securities regulation, one size of disclosure does not fit all, due to the varied and often complex nature of material weaknesses. Moreover, it is an area that is reviewed by lawyers in the Commission’s Division of Corporation Finance who coordinate with the Division’s accounting Staff. We will all continue to learn and adapt to this new disclosure environment. Registrants’ disclosures in this area contain significant variation and frequent noncompliance with the basic disclosure requirements established by the Commission. The disclosure that appeared to work for one registrant six months ago may not be acceptable for another registrant today. Moreover, no body of case law regarding internal control over financial reporting disclosure has developed, and the Commission has yet to bring an enforcement case on this disclosure. Currently, the principal sources of authority consist of Commission releases, Staff FAQ releases, and Staff comments. This Chapter is intended to assist practitioners and the companies they represent in working in this challenging area of disclosure.
EXPLANATORY NOTE

This section consists of three parts: (1) the text, which contains required elements of the Item 9A disclosure; (2) the footnotes, which contain background information, citations to pertinent authority, and general drafting guidance; and (3) Appendix A, which contains a checklist of representative fact-specific measures that could be taken to remediate a material weakness. We suggest two alternative approaches for practitioners using this guide. To understand the entire template, read each sentence followed by its corresponding footnote or footnotes. Alternatively, to answer a specific question, locate the applicable sentence in the text and then review the annotations in the accompanying footnote.
ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

As required by Rules 13a-15 and 15d-15 under the Securities Exchange Act of 1934, management has evaluated, with the participation of our chief executive officer and chief financial officer, the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and of our internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) as of the end of the period covered by this annual report.

The reporting company’s management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)). The reporting company’s management conducted an evaluation of the effectiveness of the company’s internal control over financial reporting as of December 31, 2014. In making this assessment, management used the framework set forth in the Internal Control - Integrated Framework (2013 Framework) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

The company’s internal control over financial reporting was designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America.

Management’s evaluation of internal control over financial reporting included assessing the effectiveness of internal control over financial reporting based on criteria established in Internal Control - Integrated Framework (2013 Framework) issued by COSO.

This annual report does not include an attestation report of the company’s registered public accounting firm regarding internal control over financial reporting. Management’s report was not subject to attestation by the company’s registered public accounting firm pursuant to rules of the Securities and Exchange Commission that permit the company to provide only management’s report in this annual report.

Management has concluded that, as of December 31, 2014, the company maintained effective internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)).

This annual report does not include an attestation report of the company’s registered public accounting firm regarding internal control over financial reporting. Management’s report was not subject to attestation by the company’s registered public accounting firm pursuant to rules of the Securities and Exchange Commission that permit the company to provide only management’s report in this annual report.


The disclosure must state that management’s evaluation satisfied the elements of the evaluation required under Rules 13a-15 and 15d-15.

Management’s review of disclosure controls and procedures should focus on (i) developments since the most recent evaluation; (ii) areas of weakness or ongoing concern; and (iii) other aspects of disclosure controls and procedures that “merit attention.” Adopting Release at 19. Evaluation of disclosure controls and procedures necessarily entails consideration of “the elements of internal control over financial reporting that are subsumed within disclosure controls and procedures.” Adopting Release at 19. In the
chief financial officer,\textsuperscript{4} the effectiveness\textsuperscript{5} of our disclosure controls and procedures as of the end of the period covered by this report.\textsuperscript{6} Disclosure controls and procedures refer to controls and other procedures designed to ensure that information required to be disclosed in the reports we file or submit under the Exchange Act is recorded, processed, summarized, and reported, within the time periods specified in the rules and forms of the Securities and Exchange Commission. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in our reports that we file or submit under the Exchange Act is accumulated and communicated to management, including our chief executive officer and chief financial officer, as appropriate to allow timely decisions regarding our required disclosure.\textsuperscript{7} In designing and evaluating our disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated,\textsuperscript{8} can provide only reasonable assurance\textsuperscript{9} of achieving the desired control context of a quarterly evaluation of disclosure controls and procedures, however, testing procedures are not necessarily required as to the components of internal control over financial reporting that are subsumed within disclosure controls and procedures based on the differing nature of a disclosure controls and procedures review. See Adopting Release at 19 n.93 (“[W]here 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.”).  

\textsuperscript{4} Although Rules 13a-15 and 15d-15 refer to the “principal executive officer” and “principal financial officer” of the registrant, this chapter refers to these positions by the CEO and CFO titles.  

\textsuperscript{5} The “controls and procedures” disclosure requires a statement of the CEO and CFO’s conclusions regarding the effectiveness of the issuer’s disclosure controls and procedures as of the end of the reported period, based on the required evaluation. See Item 307 or Regulation S-K (requiring disclosure of “the conclusions of the registrant’s principal executive and principal financial officers, or persons performing similar functions, regarding the effectiveness of the registrant’s disclosure controls and procedures (as defined in Rule 13a-15(e) or Rule 15d-15(e) under the Exchange Act) as of the end of the period covered by the report, based on the evaluation of these controls and procedures required by paragraph (b) of Rule 13a-15 or Rule 15d-15 under the Exchange Act’’). The disclosure must specifically state whether disclosure controls and procedures are “effective,” rather than using “adequate” or other terminology. In addition, the Staff will not permit negative assurance disclosure (e.g., indicating that “nothing has come to management’s attention to suggest that internal control over financial reporting is not effective’’). \textit{Cf. infra} note 25 (citing Adopting Release at 13 n.62; FAQ 5) (explaining that, for internal control over financial reporting disclosure, the Staff prohibits disclosure using a negative assurance approach or a conclusion of effectiveness that is subject to stated exceptions).  

\textsuperscript{6} The evaluation of the effectiveness of disclosure controls and procedures must occur “as of the end of the period covered by the report.” Item 307 of Regulation S-K. Although the statement of effectiveness of the issuer’s disclosure controls and procedures must be made as of the end of the period, the actual evaluation is an ongoing process and need not occur on the last day of the period. Adopting Release at 21 n.97.  

\textsuperscript{7} This phrase tracks the full definition of “controls and procedures” contained in Rules 13a-15(e) and 15d-15(e), which the Staff requires if the disclosure includes a definition of the term. Disclosure using any alternative definition will trigger a Staff comment on review.  

\textsuperscript{8} The phrase “designed or operated” derives from the text of the required Section 302 certification. See Item 601(b)(31)(i) of Regulation S-K (referring to the “design or operation of internal control over financial reporting”).  

\textsuperscript{9} The Staff has permitted this disclaimer only on the condition that the disclosure contain an express statement regarding whether the issuer’s controls and procedures are in fact effective at the reasonable
objectives, and management was required to apply its judgment in evaluating and implementing possible controls and procedures.

As described below, a material weakness was identified in our internal control over financial reporting. The Public Company Accounting Oversight Board’s Auditing Standard No. 2 defines a material weakness as a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. As a result of the material weakness, our chief executive officer and chief financial officer have concluded that, as of __________, the end of the period covered by this report, our disclosure controls and procedures were not effective at a reasonable assurance level.

assurance level. See Adopting Release at 22 (recognizing that “some companies have indicated that disclosure controls and procedures are designed only to provide ‘reasonable assurance’ that the controls and procedures will meet their objectives” and that the Staff has required such companies to “set forth, if true, the conclusions of the principal executive and principal financial officer that the disclosure controls and procedures are, in fact, effective at the ‘reasonable assurance’ level”). Similarly, for companies disclosing that there is “no assurance” that disclosure controls and procedures will operate effectively under all circumstances, the Staff requires clarification that “the disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives” and express disclosure, if true, that the principal executive and principal financial officers have concluded “that the controls and procedures are, in fact, effective at the ‘reasonable assurance’ level.” Id.

10 The PCAOB recognizes, in paragraph 16 of Auditing Standard No. 2, that internal control over financial reporting is “subject to lapses in judgment and breakdowns resulting from human failures.”

11 The purpose of placing this sentence at this point in the section is to introduce without elaboration the material weakness as the cause underlying the ineffectiveness of the issuer’s disclosure controls and procedures. A material weakness in internal control over financial reporting during a given reporting period will ordinarily mean that disclosure controls and procedures were not effective during that reporting period. The detailed discussion of the material weakness follows in the section regarding internal control over financial reporting. In the absence of a material weakness, the mere presence of one or more significant deficiencies (provided that such deficiencies do not aggregate to a material weakness) ordinarily does not require disclosure. See infra note 24 (citing Adopting Release at 14; FAQ 11; FAQ 20).

12 Although the Adopting Release preceded the implementation of PCAOB Auditing Standard No. 2 and defined “significant deficiency” and “material weakness” by reference to Generally Accepted Auditing Standards at the time, the Staff has clarified that it will “apply the PCAOB definitions in interpreting the Commission rules in this area” because the Commission’s intention was to incorporate the definitions of those terms “as they exist in the standards used by auditors of public companies.” FAQ 13.

13 Consider including, if appropriate, additional disclosure regarding the nexus between the material weakness and internal control over financial reporting. Disclosure controls and procedures require timely disclosure of financial statements in compliance with Regulation S-X, whereas a material weakness refers to a control deficiency, or combination of deficiencies, that results in more than a remote likelihood that a material misstatement of the registrant’s annual or interim financial statements will not be prevented or detected. As a result, a material weakness in internal control over financial reporting during a given reporting period usually means that disclosure controls and procedures were not effective during that reporting period. See supra note 11. For the interaction between disclosure controls and procedures, on the one hand, and internal control over financial reporting, on the other hand, see infra note 16.

14 The report must include the CEO and CFO’s conclusions regarding the effectiveness of the issuer’s controls and procedures. See Item 307 of Regulation S-K. Failure to do so routinely triggers a Staff comment requiring the issuer to comply with Item 307 by including the certifying officers’ express statement regarding the effectiveness of the issuer’s controls and procedures.
Management is responsible for establishing and maintaining adequate internal control over our financial reporting.\(^{15}\)

Internal control over financial reporting\(^{16}\) refers to a process designed by, or under the supervision of, our chief executive officer and chief financial officer and effected by our board of directors,\(^ {17}\) management, and other personnel, to provide reasonable

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\(^{15}\) This express statement is required under Item 308(a)(1) of Regulation S-K. Management is not required personally to “conduct the necessary activities to evaluate the design and test the operating effectiveness” of internal control over financial reporting. Adopting Release at 15 n.78. Such activities, including activities that provide management with the information for its assessment, “may be conducted by non-management personnel acting under the supervision of management.” *Id.*

\(^{16}\) The definition of “internal control over financial reporting” contained here tracks the language of Rules 13a-15(f) and 15d-15(f). Although Section 302 refers to “internal controls” and Section 404 refers to “internal control structure and procedures for financial reporting,” the Commission ultimately adopted the term “internal control over financial reporting” in its implementation of Section 404. *See* Rules 13a-15(f) and 15d-15(f) (defining “internal control over financial reporting”); Item 601(b)(31)(i)(5) of Regulation S-K (prescribing the certification regarding management’s evaluation of “internal control over financial reporting”). The Commission explained that the term “internal control over financial reporting” is more consistent with the preexisting terminology in the auditing literature, avoids confusion that could result from new terminology and “best encompasses the objectives of the Sarbanes-Oxley Act.” *Id.*

\(^{17}\) The COSO Framework emphasizes “involvement of the board or audit committee in overseeing the financial reporting process, including assessing the reasonableness of management’s accounting judgments
assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

- pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of our assets;
- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and members of our board of directors; and
- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of our assets that could have a material effect on our financial statements.

Internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives because of its inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. Internal control over financial reporting also can be circumvented by collusion or improper override. Because of such limitations, there is a risk that material misstatements may not be prevented or detected on a timely basis by internal control over financial reporting. However, these inherent limitations are known features of the financial reporting process, and it is possible to design into the process safeguards to reduce, though not eliminate, this risk.

Management evaluated the effectiveness of our internal control over financial reporting as of ________ using the framework set forth in the report of the Treadway Commission’s Committee of Sponsoring Organizations (COSO), “Internal Control—

and estimates and reviewing key filings with regulatory agencies” as “an important element” of internal control over financial reporting. Adopting Release at 9 n.50 (quoting the COSO Framework).

This qualification and the following sentences track the language of paragraph 16 of Auditing Standard No. 2. The management report on internal control over financial reporting may include these qualifications but must, in any event, affirmatively state whether internal control over financial reporting is effective so as to satisfy the requirement that the report contain management’s “assessment of the effectiveness of the registrant’s internal control over financial reporting as of the end of the registrant’s most recent fiscal year, including a statement as to whether or not internal control over financial reporting is effective.” Item 308(a)(3) of Regulation S-K. Moreover, any discussion of “reasonable assurance” must be clear and comprehensible. Adopting Release at 22 (noting that the “concept of reasonable assurance is built into the definition of internal control over financial reporting” and that if “management decides to include a discussion of reasonable assurance in the internal control report, the discussion must be presented in a manner that neither makes the disclosure in the report confusing nor renders management’s assessment concerning the effectiveness of the company’s internal control over financial reporting unclear”).

Although the statement of effectiveness of the issuer’s internal control over financial reporting must be made as of the end of the period, the actual evaluation is not required to be made on the last day of the period. Adopting Release at 21 n.97.

The National Commission on Fraudulent Financial Reporting, popularly known as the Treadway Commission, was sponsored by the AICPA, the American Accounting Association, the Financial
Integrated Framework.”[21] The scope of management’s evaluation excluded the [describe material acquisition], which we acquired __________, as described in Frequently Asked Question No. 3 (Oct. 6, 2004) regarding Release No. 34-47986, “Management’s Report on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports” (June 5, 2003). Accordingly, management’s assessment of our internal control over financial reporting does not include internal control over financial reporting of [acquired business], which represented ___% of our total assets and ___% of our net assets at __________, and generated ___% of our total revenue and ___% of our net income during the year then ended.][22]


21 Item 308(a)(2) of Regulation S-K requires the management report to identify “the framework used by management to evaluate the effectiveness of the registrant’s internal control over financial reporting,” as required by Rules 13a-15(c) and 15d-15(c). Under these rules, management must evaluate the effectiveness of the issuer’s internal control over financial reporting based on “a suitable, recognized control framework that is established by a body or group that has followed due-process procedures, including the broad distribution of the framework for public comment.” The Commission has indicated that the COSO Framework satisfies these criteria “and may be used as an evaluation framework for purposes of management’s annual internal control evaluation and disclosure requirements,” although the Commission has expressly stated that Rules 13a-15(c) and 15d-15(c) do not “mandate use of a particular framework” and that appropriate frameworks other than COSO “may be developed within the United States in the future.” Adopting Release at 13. In addition to the COSO framework, the Staff has identified two other “sources of guidance” available to assist management in fulfilling its responsibilities to assess and document internal control over financial reporting: (i) the “existing books and records requirements” and (ii) the Adopting Release. FAQ 18. Outside of the United States, the Commission cited examples of “other suitable frameworks” in addition to the COSO Framework. Adopting Release at 13 n.67 (citing the “Guidance on Assessing Control,” published by the Canadian Institute of Chartered Accountants, and the “Turnbull Report,” published by the Institute of Chartered Accountants in England and Wales). The Staff has indicated that it “would support efforts by bodies such as COSO to develop an internal control framework specifically for smaller issuers,” FAQ 16, and COSO is currently in the process of developing such a framework.

22 Under FAQ 3, the management’s report may exclude an acquired business if the report (i) identifies the acquired business; (ii) indicates the significance of the acquired business to the issuer’s consolidated financial statements; (iii) discloses any material change to the issuer’s internal control over financial reporting due to the acquisition; (iv) covers a period that is not more than one year from the date of acquisition; and (v) does not repeat the omission of the acquisition from a prior annual management report on internal control over financial reporting. The scope limitation in FAQ 3, covering acquired businesses, is the most common of the three permitted types of scope limitations on management’s report on internal control over financial reporting. The Staff will not permit any other limitations on the scope of the management’s report. See FAQ 19 (observing that Item 308 of Regulation S-K “does not permit management to issue a report on internal control over financial reporting with a scope limitation” except as provided in FAQ 1, 2, and 3). The other two permitted scope limitations apply to variable interest entities consolidated in the financial statements of an issuer that does not have the contractual or other authority to assess the consolidated entity’s internal control over financial reporting, FAQ 1, and equity method investees, FAQ 2. In each case, the issuer should indicate the significance of the matter described, by disclosing “any key sub-totals, such as total and net assets, revenues and net income that result from consolidation of entities whose internal controls have not been assessed.” FAQ 1.
As a result of [management’s evaluation of our internal control over financial reporting, management] [our independent registered public accounting firm’s field work in support of its audit of our financial statements for the year ended __________, our independent registered public accounting firm] identified a material weakness in our internal control. Specifically, [management] [our independent registered public accounting firm] concluded that [detailed description of material weakness].

As a result of the material weakness, [management has concluded that our internal control over financial reporting was ineffective as of __________.]

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23 The disclosure should indicate whether management or the auditors identified the material weakness.

24 The existence of a material weakness represents the “threshold for concluding that a company’s internal control over financial reporting is effective.” Adopting Release at 14. As a result, the assessment of the effectiveness of the issuer’s internal control over financial reporting “must include disclosure of any material weakness” in the issuer’s internal control over financial reporting, and management cannot conclude that the issuer’s internal control over financial reporting is effective if one or more material weaknesses exist. Item 308(a)(3) of Regulation S-K. If a material weakness exists, the disclosure should expressly use the term “material weakness,” rather than an alternative description. See FAQ 20 (noting that, although the rule “does not require management to use any specific language in their report,” the Staff would “generally expect” the report to include the term “material weakness” for purposes of providing full disclosure relating the material weakness). In contrast, significant deficiencies in internal control over financial reporting do not warrant disclosure unless the significant deficiency (i) is material to understanding required disclosure regarding the circumstances of a material weakness or (ii) resulted in a material change to either disclosure controls and procedures or internal control over financial reporting. FAQ 11. In all likelihood, however, any significant deficiency that satisfies these criteria and therefore requires disclosure should be categorized as a material weakness. Compare Refco Inc. Final Prospectus (Aug. 10, 2005) available at <http://www.sec.gov/Archives/edgar/data/1321746/000104746905021309/a2162155z424b1.htm> (disclosing two “significant deficiencies,” but no material weakness, based on Refco’s (i) need to increase its “existing finance department resources to be able to prepare financial statements that are fully compliant with all SEC reporting guidelines on a timely basis” and (ii) lack of formalized procedures for closing its books) with Refco Inc. Form 8-K (Oct. 11, 2005) available at <http://www.sec.gov/Archives/edgar/data/1321746/000110465905048112/a05-17426_18k.htm> (disclosing that Refco’s financial statements for 2002 through 2005 “should no longer be relied upon”).

25 The report must contain an express statement regarding the effectiveness or ineffectiveness of the issuer’s internal control over financial reporting as of the most recent fiscal year-end as part of management’s assessment of the issuer’s internal control over financial reporting. Item 308(a)(3) of Regulation S-K. The Staff will not permit negative assurance disclosure (e.g., indicating that “nothing has come to management’s attention to suggest that internal control over financial reporting is not effective”), Adopting Release at 13 n.62, or a conclusion stating that internal control over financial reporting is “adequate” or using other alternative terminology. Nor will the Staff permit management to state that internal control over financial reporting is effective “except to the extent certain problems have been identified” or “subject to certain qualifications or exceptions.” FAQ 5. The presence of one or more material weaknesses will preclude a finding that the issuer’s internal control over financial reporting is effective. Item 308(a)(3) of Regulation S-K; see also FAQ 5. Issuers are required to “maintain evidential matter, including documentation, to provide reasonable support for management’s assessment of the effectiveness” of the issuer’s internal control over financial reporting. See Instructions to Item 308 of Regulation S-K. Foreign private issuers must state affirmatively whether their internal controls are effective, even if such issuers employ a permitted non-U.S. evaluation framework that does not require such an affirmative statement. See Adopting Release at 14 n.68. A conclusion that internal control over financial reporting is not effective does not impair the issuer’s status as timely and current in its Exchange Act reports for purposes of Rule 144 and Forms S-3 and S-8, provided that the auditor’s report on the issuer’s financial statements is unqualified. FAQ 4. A study by PricewaterhouseCoopers LLP of 3,263 accelerated filers found that, as of September 30, 2005, 14.5% had adverse reports on internal control over
independent registered public accounting firm, __________ LLP, has issued an audit report on management’s assessment of our internal control over financial reporting, expressing an unqualified opinion on management’s assessment and an adverse opinion on the effectiveness of our internal control over financial reporting as of __________.  

Additional Information Regarding the Material Weakness(es)

[Provide additional disclosure regarding each material weakness: (1) who found it? (2) when did they find it? (3) what is it? (4) where does it come from? (5) how long has it existed? (6) why did it happen? (7) how does it affect financial reporting and disclosure controls and procedures? (8) how are you going to fix it? i.e., (a) what is being done to fix it? (b) who is fixing it? (c) when is it going to be fixed?)

[What has the company done to be sure that, notwithstanding the material weaknesses, the financial statements being filed are correct?] [To address the material weaknesses described above, we performed additional analysis and other post-closing procedures to ensure that the consolidated financial statements were prepared in accordance with generally accepted accounting principles. These procedures included: [provide a fact-specific list here]. Accordingly, management believes that the financial statements included in this report fairly present in all material respects the company’s financial position, results of operations, and cash flows for the periods presented.]
To remediate the material weakness described above and enhance our internal control over financial reporting, management has implemented the following changes:

[See Appendix A, which contains a checklist of representative fact-specific measures taken to remediate each material weakness.]

**Changes in Internal Control over Financial Reporting**

Management has evaluated, with the participation of our chief executive officer and chief financial officer, whether any changes in our internal control over financial reporting that occurred during our last fiscal quarter have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. Based on the evaluation we conducted, management has implemented changes in [__________ as a result of ________]. However, management believes the measures that have been implemented to remediate the material weakness have had a material impact on our internal control over financial reporting.

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28 For the Item 308(c) evaluation of changes in internal control over financial reporting, “it is unnecessary to specify a date for the quarterly evaluation,” in contrast to the Item 307 evaluation of disclosure controls and procedures, which must be made “as of the end of the period covered by this report.” See Adopting Release at 21; Items 307 and 308(c) of Regulation S-K.

29 For Item 9A of Form 10-K, this is the fourth fiscal quarter of the year covered by the Form 10-K. See Item 308(c) of Regulation S-K.

30 The management report must disclose any change in the issuer’s internal control over financial reporting identified in connection with the evaluation required by Rules 13a-15(d) and 15d-15(d) that occurred during the issuer’s last fiscal quarter (the fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting. Item 308(c) of Regulation S-K. Most issuers have been providing the disclosure described under Item 308(c), despite confusion over its effective date. Compare Adopting Release at 1 (stating that an issuer “must begin to comply with the requirements regarding evaluation of any material change to its internal control over financial reporting in its first periodic report due after the first annual report required to include a management report on internal control over financial reporting” (emphasis added)) with Adopting Release at 30 (stating that Item 308(c) of Regulation S-K, “requiring disclosure regarding certain changes in internal control over financial reporting,” became effective as of Aug. 14, 2003). See also FAQ 9 (explaining that the Staff would “would welcome disclosure of all material changes to controls, whether or not made in advance of the compliance date of the rules under Section 404 of the Sarbanes-Oxley Act,” but “would not object if a registrant did not disclose changes made in preparation for the registrant’s first management report on internal control over financial reporting” provided that no material weakness is identified).

31 In Item 9A of Form 10-K, the disclosure of changes in internal control over financial reporting covers only the fourth fiscal quarter of the year covered by the Form 10-K. See supra note 28 (citing Item 308(c) of Regulation S-K). Depending on the circumstances, issuers may need to disclose the reasons for changes that occurred during the fourth quarter. Adopting Release at 21 (“Although the final rules do not explicitly require the company to disclose the reasons for any change that occurred during a fiscal quarter, or to otherwise elaborate about the change, a company will have to determine, on a facts and circumstances basis, whether the reasons for the change, or other information about the circumstances surrounding the change, constitute material information necessary to make the disclosure about the change not misleading.” (citing Rules 10b-5 and 12b-20)). For example, management should provide detailed disclosure if a material weakness has been identified. See FAQ 9 (noting that “if the registrant were to identify a material weakness, it should carefully consider whether that fact should be disclosed, as well as changes made in response to the material weakness”).
since __________, and anticipates that these measures and other ongoing enhancements will continue to have a material impact on our internal control over financial reporting in future periods.

Report of Independent Registered Public Accounting Firm

[Insert here the attestation report of the issuer’s independent registered public accounting firm,\(^\text{32}\) in the form and content required under Rule 2-02 of Regulation S-X.\(^\text{33}\) An issuer can benefit from separating the attestation report on management’s assessment of internal control over financial reporting from the auditor’s report on the financial statements,\(^\text{34}\) although prevailing practice for many auditors is to provide an integrated opinion. All parties involved should be sensitive to auditor independence issues in this area\(^\text{35}\) and the related guidance from the Commission and the PCAOB encouraging closer coordination between issuers and their independent registered public accountants.\(^\text{36}\) In the event that a filing under the Securities Act incorporates the

\(^{32}\) Item 308(b) of Regulation S-K requires inclusion of the independent registered public accounting firm’s attestation report on management’s assessment of the issuer’s internal control over financial reporting. The Commission indicated that “it is important for management’s report to be in close proximity to the corresponding attestation report.” Adopting Release at 15.

\(^{33}\) Rule 2-02 of Regulation S-X prescribes the form and content of the attestation report required in every annual report under Section 13(a) or Section 15(d) that contains management’s assessment of internal control over financial reporting. Specifically, the accountant’s attestation report must “be dated, signed manually, identify the period covered by the report and clearly state the opinion of the accountant as to whether management’s assessment of the effectiveness of the registrant’s internal control over financial reporting is fairly stated in all material respects, or must include an opinion to the effect that an overall opinion cannot be expressed,” in which case the report must “explain why” an overall opinion cannot be expressed. Rule 2-02 of Regulation S-X.

\(^{34}\) Rule 2-02 of Regulation S-X expressly permits the auditor to separate its attestation report on management’s assessment of internal control over financial reporting from the auditor’s report on the financial statements, and separate reports can avoid issues that can arise in the event that the auditor needs to reissue its report on the issuer’s financial statements or if the audit report is incorporated by reference into a Securities Act filing. FAQ 15.

\(^{35}\) Management cannot delegate to its independent registered public accounting firm the responsibility to assess the issuer’s internal control over financial reporting, nor can management satisfy auditor independence requirements by accepting responsibility for documentation and testing performed by the auditor. Adopting Release at 14 n.71. However, some level of interaction and coordination is permitted between the independent registered public accountant and the issuer, provided that the issuer maintains its active involvement in documenting and testing internal control over financial reporting. The independent registered public accountant may “assist management in documenting” the issuer’s internal control over financial reporting, and the Commission expressly recognized “the need for coordination” between management and the independent registered public accountant, but management “must be actively involved in the process.” Adopting Release at 14.

\(^{36}\) See PCAOB Report, supra note 1; Office of the Chief Accountant, Division of Corporation Finance: Staff Statement on Management’s Report on Internal Control over Financial Reporting (May 16, 2005); PCAOB Policy Statement Regarding Implementation of Auditing Standard No. 2, Audit of Internal Control over Financial Reporting Performed in Conjunction with an Audit of Financial Statements (May 16, 2005); cf. FAQ 17 (permitting the auditor to “provide limited assistance to management in documenting internal controls and making recommendations for changes to internal controls,” provided that “management has the ultimate responsibility for the assessment, documentation and testing” of the issuer’s internal control over financial reporting). In addition, the Staff has indicated that an accountant’s attestation report that
Form 10-K by reference, the filing must include a consent for “all accountants' reports,” which includes the accountant’s report on management’s assessment of internal control over financial reporting.  

identifies a material weakness even though management’s internal control report does not, or vice versa, does not constitute a reportable “disagreement” under Item 304 of Regulation S-K. FAQ 6.

37 FAQ 21 (noting that a new consent is required for any amendment to the registration statement for (i) any non-typographical change to the audited financial statements or (ii) the discovery of any facts that may affect the accountant’s report on internal control over financial reporting).
APPENDIX A
(CHECKLIST OF POTENTIAL REMEDIAL MEASURES)

EXPLANATORY NOTE
The following items are intended to provide a partial checklist of potential remedial measures. Whether a particular measure properly contributes to the remediation of a material weakness requires the exercise of independent judgment and will depend upon the facts and circumstances. Accordingly, this Appendix is not intended to be used as a fill-in-the-blank form. Although the items below are grouped under general categories based upon the type of material weakness involved, the categories overlap in many circumstances. In addition, the remedial measures described below are not an exclusive list and cannot be applied mechanically. The actual steps relating to remediation will necessarily depend on the facts and circumstances of the registrant and the material weakness involved.

Company-Level Material Weakness

- Adopted a plan under which we expect to evaluate using the COSO framework our internal control over financial reporting as of __________ (the end of our most recent accounting period) to determine if our internal control over financial reporting was effective as of that date and under which we expect to disclose the results of the evaluation in our next quarterly report on Form 10-Q. Under this plan, we expect to [describe specific steps envisioned]. However, our independent registered public accounting firm will not evaluate the measures we intend to take to address the material weakness[es] and will not audit our internal control over financial reporting until __________.

- Established an accounting function at the parent company level. The __________ divisional controller was promoted to corporate controller and will be responsible for setting and establishing our accounting policies and those of our two divisions in accordance with GAAP and guidelines required by the Securities and Exchange Commission. To assist the corporate controller, we have also promoted an individual to a newly created position of manager of financial reporting. In addition, we have subscribed to an online research tool to assist this group in staying abreast of new accounting pronouncements, proper accounting disclosure, and research of technical accounting issues relating to our ongoing business transactions. At the __________ division, we have hired a new controller and accounting manager.

- Engaged a professional accounting services firm to provide an internal audit function, subject to the direct oversight of our audit committee, and to assist management in its ongoing review and, to the extent necessary, revision of our policies and procedures related to our internal control over financial reporting.

- Replaced our accounting management and most of our accounting staff with more experienced personnel with additional training and expertise, including an experienced chief accounting officer and controller.

- Enlarged the size of our accounting staff from _____ employees to _____ employees, including additional management-level accounting personnel, which enables further segregation of duties and allows additional levels of internal review and supervision within our accounting organization.
• Established formal, documented accounting policies and procedures to improve our internal control over financial reporting, including policies and procedures relating to approvals, accruals, documentation requirements, standardized recordkeeping, asset tracking, the use of our purchase order system, and our financial statement close process.

• Formed a disclosure committee comprising members of our financial management and representatives from our accounting, legal, and investor relations departments, the minutes of which are reviewed with the audit committee.

• Improved the documentation of our significant accounting policies, which are reviewed with our audit committee.

• Engaged __________ to assist us with documenting processes, performing testing and reviewing our internal control over financial reporting in connection with our assessment under Section 404 of the Sarbanes-Oxley Act of 2002 for the year 2005.

• Developed a remediation plan to address the deficiencies identified in our internal control over financial reporting, including the material weaknesses described above in our management’s report.

**Insufficient Personnel Who Understand GAAP**

• Updated our U.S. GAAP financial statement disclosure requirements checklists for use by our U.S. and __________ accounting and finance personnel as a reference tool during our interim and year-end reporting periods. We have also fostered closer cooperation between our U.S. and __________ accounting and financial reporting teams through, for example, regular meetings and visits between the teams, implementing U.S. GAAP training and regular review of U.S. GAAP accounting issues. Our director of financial reporting, who has international business experience, provides additional oversight to ensure consistency, to maintain communication and to enhance the knowledge of U.S. GAAP between and within our U.S. and __________ financial reporting teams.

• Improved our audit committee charter and committee functions by expanding our audit committee charter to include in its scope the responsibility to review and approve all new, or changes to, significant accounting policies and positions. We have also expanded both the number of audit committee meetings from four to eight standing meetings, and the duration of those meetings, which allows a more in-depth review of complex accounting issues.

• Increased training of all personnel involved in the [physical inventory] process at the __________ division, particularly those individuals performing the [data entry] function. Additionally, the [physical inventory report] was revised such that any [inventory item that does not include a corresponding item number] will result in an exception requiring follow-up by management. The __________ division has also implemented enhanced review procedures by senior management of the reconciliation process between the quantities obtained from the physical inventory tags and the quantities obtained from the updated perpetual inventory report.

• Created and filled the position of director of financial reporting.
• Enhanced our corporate accounting function by creating and filling the new position of [assistant controller].
• Hired additional experienced [tax] staff including a new vice president of [tax] and two additional senior level [tax] managers.
• Adopted a modified version of our U.S. GAAP financial statement disclosure requirements checklist for use by our ________ accounting and finance personnel.
• Commenced a training program to upgrade the skill sets of our ________ accounting staff.
• Hired an experienced controller to coordinate all financial reporting, monthly physical inventory counts and verification, and to participate in the weekly conference calls with all of our operations to improve communications.

Financial Close Process
• Retained the services of another major public accounting firm to assist us in re-closing our ________ financial statement periods. This process included re-performing accounting reconciliations for all accounts where errors were detected during the initial phases of the audit. Upon completion of the re-closing, our independent registered public accounting firm concluded the audit of the ________ consolidated financial statements, and related restatement of information in the ________ consolidated financial statements.
• Identified, reviewed, analyzed, and corrected all instances of errors in our records, procedures, and controls.
• Established steps in our monthly closing process to improve our internal control over financial reporting. These steps include designing appropriate standard monthly journal entries to account for this activity, training accounting personnel on the proper accounting treatment, and instituting review and approval controls in this area.
• Re-closed each of our quarterly financial statement periods for ________ and engaged our independent registered public accounting firm to perform a review of each quarterly period in ________ under Statement on Auditing Standard No. 100, Interim Financial Information, or SAS 100.
• Implemented a formalized account reconciliation policy and procedures that included intensive training of our accounting team both in the U.S. and Europe to ensure that these reconciliations are completed at each period-end on a timely basis. Although temporary employees or contractors reconciled many of our accounts, we intend to have permanent, qualified employees perform these reconciliations in the future. As an interim step until the account reconciliation process is fully functional for all general ledger accounts, all significant general ledger accounts were assigned to personnel for reconciliation and subsequent to period end were reconciled for the periods ended ________.

Transaction Accounting
• Engaged ________ to be directly involved in the review and accounting evaluation of our calculations of ________ and any other complex or non-routine transaction.
• Revised our procedures related to internal control over financial reporting to require the involvement of both internal accounting personnel and ________ in the evaluation of, and the application of generally accepted accounting principles to, any complex or non-routine transaction.
• Required certain internal accounting personnel, including our senior accounting personnel, to receive additional training regarding _________ and other complex or non-routine transactions.
• Purchased and began implementation of new software that will automate and improve controls in this activity.
• Adopted additional controls to prevent access to the software applications that certain management level personnel previously had, which permitted them to change or record transactions in our financial reporting software application.
• Conducted a review and evaluation of the access to our financial reporting software applications by all personnel, and reassigned the access rights used to control the financial reporting process.
• Implemented remedial control procedures to address operating systems access and control policies and procedures relating to certain _________ transaction cycles. We also are in the process of implementing remedial control procedures to address firewall protections and information technology back-up and recovery.
• Determined that a major integrated system upgrade was required to replace the current in-house forecasting, meter tracking, and sales systems. We have evaluated several third party systems and have begun implementation on our selections; established procedures to reconcile demand and load factors among the various in-house systems until the integrated system can be fully implemented; established procedures to reconcile _________ on a _________ basis among the various in-house systems until the integrated system can be fully implemented; established senior level management oversight of the _________ process, including weekly update and reporting meetings.

Revenue Recognition

• Discontinued the deferred payment arrangement under which we held the manufacturer’s certificate of origin as security for payment. During _________, our _________ division revised its quarterly closing procedures to strengthen its review of any new agreements or other terms to determine whether the related transactions are accounted for in the proper period.
• Changed our method of accounting for [sales incentive programs] that are paid directly to the dealer sales representatives. These [sales incentives] are now classified as [a reduction of revenue rather than as a selling expense]. These sales incentives were restated for all years presented in the Form 10-K for the fiscal year ended _________ and have been properly classified in the _________ quarters of _________. As more fully discussed above, we have increased our personnel and expertise within our accounting function. In addition, management has revised our quarterly closing procedures to strengthen our review of all existing [sales incentive] programs to ensure they are accounted for correctly.
• Enhanced our revenue recognition procedures by updating our contract evaluation criteria and decision process flowcharts. These evaluation and process updates were developed as a result of performing a thorough review of applicable accounting literature related to revenue recognition, particularly EITF No. 00-21, “Accounting for Revenue Arrangements with Multiple Deliverables.”

• Modified our revenue recognition procedures on software contracts requiring post-contract customer support in accordance with the guidelines of SOP 97-2, “Software Revenue Recognition,” and subsequent interpretations.

• Enhanced our revenue recognition procedures to assure vendor-specific objective evidence is obtained to establish fair value for undelivered software elements prior to recognizing revenue.

• Implemented additional training for accounting personnel to enhance their understanding of the applicable revenue recognition principles.

• Implemented additional training for our sales personnel to enhance communications of pertinent revenue information to our accounting department that would affect accounting for agreements containing multiple deliverables.

Stock Option Grant Process

• Implemented cross functional teams composed of members of our legal, accounting, and human resources departments to develop improvements in the [stock option granting] process.

• Formalized guidelines relating to the [size and vesting schedule] of [stock option grants for all new employees and on-going employee grants].

• Improved the documentation of the actions of the compensation committee and grant subcommittee regarding stock option granting.

• Made personnel changes in areas associated with the stock option granting process to increase the levels of experience of the personnel involved.

• Increased the frequency of stock option grants, moving to grants on a two to three week routine cycle, and significantly reduced the processing time between grant dates and the delivery of option paperwork to employees.

• Increased the size of the compensation committee of our board of directors to three independent members.

• The compensation committee refined and limited delegation of authority to a subcommittee to grant stock options.

• Documented a formal written policy regarding our stock option granting process.

• Created a pre-determined schedule for employee stock option grants, including enhancements with respect to the grant routine cycle.

• Adopted a policy not to grant executive officers options when trading is restricted for executives under our insider trading policy.
ITEM 9A TEMPLATES (UNANNOTATED)

EXPLANATORY NOTE
The following disclosure template sets forth the standard Item 9A elements but omits the detailed comments and citations provided in the annotated version, which is otherwise identical to this template.

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures
As required by Rules 13a-15 and 15d-15 under the Securities Exchange Act of 1934, management has evaluated, with the participation of our chief executive officer and chief financial officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Disclosure controls and procedures refer to controls and other procedures designed to ensure that information required to be disclosed in the reports we file or submit under the Exchange Act is recorded, processed, summarized, and reported, within the time periods specified in the rules and forms of the Securities and Exchange Commission. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in our reports that we file or submit under the Exchange Act is accumulated and communicated to management, including our chief executive officer and chief financial officer, as appropriate to allow timely decisions regarding our required disclosure. In designing and evaluating our disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management was required to apply its judgment in evaluating and implementing possible controls and procedures.

As described below, a material weakness was identified in our internal control over financial reporting. The Public Company Accounting Oversight Board’s Auditing Standard No. 2 defines a material weakness as a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. As a result of the material weakness, our chief executive officer and chief financial officer have concluded that, as of __________, the end of the period covered by this report, our disclosure controls and procedures were not effective at a reasonable assurance level.

Management’s Report on Internal Control Over Financial Reporting
Management is responsible for establishing and maintaining adequate internal control over our financial reporting.

Internal control over financial reporting refers to a process designed by, or under the supervision of, our chief executive officer and chief financial officer and effected by our board of directors, management, and other personnel, 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 and includes those policies and procedures that:
• pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of our assets;
• provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and members of our board of directors; and
• provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of our assets that could have a material effect on our financial statements.

Internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives because of its inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. Internal control over financial reporting also can be circumvented by collusion or improper override. Because of such limitations, there is a risk that material misstatements may not be prevented or detected on a timely basis by internal control over financial reporting. However, these inherent limitations are known features of the financial reporting process, and it is possible to design into the process safeguards to reduce, though not eliminate, this risk.

Management evaluated the effectiveness of our internal control over financial reporting as of _________ using the framework set forth in the report of the Treadway Commission’s Committee of Sponsoring Organizations (COSO), “Internal Control — Integrated Framework.” [The scope of management’s evaluation excluded the [describe material acquisition], which we acquired _________, as described in Frequently Asked Question No. 3 (Oct. 6, 2004) regarding Release No. 34-47986, “Management’s Report on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports” (June 5, 2003). Accordingly, management’s assessment of our internal control over financial reporting does not include internal control over financial reporting of [acquired business], which represented ___% of our total assets and ___% of our net assets at _________, and generated ___% of our total revenue and ___% of our net income during the year then ended.]

As a result of [management’s evaluation of our internal control over financial reporting, management] [our independent registered public accounting firm’s field work in support of its audit of our financial statements for the year ended _________, our independent registered public accounting firm] identified a material weakness in our internal control. Specifically, [management] [our independent registered public accounting firm] concluded that [detailed description of material weakness].

As a result of the material weakness, management has concluded that our internal control over financial reporting was ineffective as of _________ . [Our independent registered public accounting firm, _________ LLP, has issued an audit report on management’s assessment of our internal control over financial reporting, expressing an unqualified opinion on management’s assessment and an adverse opinion on the effectiveness of our internal control over financial reporting as of _________ .]
Additional Information Regarding the Material Weakness(es)

[Provide additional disclosure regarding each material weakness: (1) who found it? (2) when did they find it? (3) what is it? (4) where does it come from? (5) how long has it existed? (6) why did it happen? (7) how does it affect financial reporting and disclosure controls and procedures? (8) how are you going to fix it? i.e., (a) what is being done to fix it? (b) who is fixing it? (c) when is it going to be fixed?]

[What has the company done to be sure that, notwithstanding the material weaknesses, the financial statements being filed are correct?] [To address the material weaknesses described above, we performed additional analysis and other post-closing procedures to ensure that the consolidated financial statements were prepared in accordance with generally accepted accounting principles. These procedures included: [provide a fact-specific list here]. Accordingly, management believes that the financial statements included in this report fairly present in all material respects the company’s financial position, results of operations and cash flows for the periods presented.]

To remediate the material weakness described above and enhance our internal control over financial reporting, management has implemented the following changes:

[See Appendix A, which contains a checklist of representative fact-specific measures taken to remediate each material weakness.]

Changes in Internal Control over Financial Reporting

Management has evaluated, with the participation of our chief executive officer and chief financial officer, whether any changes in our internal control over financial reporting that occurred during our last fiscal quarter have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. Based on the evaluation we conducted, management has [concluded that no such changes have occurred] [implemented changes in ________ as a result of ________]. However, management believes the measures that have been implemented to remediate the material weakness have had a material impact on our internal control over financial reporting since ________, and anticipates that these measures and other ongoing enhancements will continue to have a material impact on our internal control over financial reporting in future periods.

Report of Independent Registered Public Accounting Firm

[Insert here the attestation report of the issuer’s independent registered public accounting firm, in the form and content required under Rule 2-02 of Regulation S-X. An issuer can benefit from separating the attestation report on management’s assessment of internal control over financial reporting from the auditor’s report on the financial statements, although prevailing practice for many auditors is to provide an integrated opinion. All parties involved should be sensitive to auditor independence issues in this area and the related guidance from the Commission and the PCAOB encouraging closer coordination between issuers and their independent registered public accountants. In the event that a filing under the Securities Act incorporates the Form 10-K by reference, the filing must include a consent for “all accountants’ reports,” which includes the accountant’s report on management’s assessment of internal control over financial reporting.]
ITEM 4 TEMPLATE (ANNOTATED)

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

As required by Rules 13a-15 and 15d-15 under the Securities Exchange Act of 1934, management has evaluated, with the participation of our chief executive officer and chief financial officer, the effectiveness of our disclosure controls and procedures as of the end of the reported period, based on the required evaluation. See Item 307 or Regulation S-K (requiring disclosure of “the conclusions of the registrant’s principal executive and principal financial officers, or persons performing similar functions, regarding the effectiveness of the registrant’s disclosure controls and procedures (as defined in Rule 13a-15(e) or Rule 15d-15(e) under the Exchange Act) as of the end of the period covered by the report, based on the evaluation of these controls and procedures required by paragraph (b) of Rule 13a-15 or Rule 15d-15 under the Exchange Act”). The disclosure must specifically state whether disclosure controls and procedures are “effective,” rather than using “adequate” or other terminology. In addition, the Staff will not permit negative assurance disclosure (e.g., indicating that “nothing has come to management’s attention to suggest that internal control over financial reporting is not effective”). Cf. supra note 25 (citing Adopting Release at 13 n.62; FAQ 5) (explaining that, for internal control over financial reporting disclosure, the Staff prohibits disclosure using a negative assurance approach or a conclusion of effectiveness that is subject to stated exceptions).
the end of the period covered by this report. Disclosure controls and procedures refer to controls and other procedures designed to ensure that information required to be disclosed in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the rules and forms of the Securities and Exchange Commission. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in our reports that we file or submit under the Exchange Act is accumulated and communicated to management, including our chief executive officer and chief financial officer, as appropriate to allow timely decisions regarding our required disclosure. In designing and evaluating our disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management was required to apply its judgment in evaluating and implementing possible controls and procedures.

Our chief executive officer and chief financial officer have concluded, based on this evaluation, that as of __________, the end of the period covered by this report, our disclosure controls and procedures were [effective at a reasonable assurance level] [not effective at a reasonable assurance level as a result of __________].

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42 The evaluation of the effectiveness of disclosure controls and procedures must occur “as of the end of the period covered by the report.” Item 307 of Regulation S-K. Although the statement of effectiveness of the issuer’s disclosure controls and procedures must be made as of the end of the period, the actual evaluation need not occur on the last day of the period. Adopting Release at 21 n.97.

43 This phrase tracks the full definition of “controls and procedures” contained in Rules 13a-15(e) and 15d-15(e), which the Staff requires if the disclosure includes a definition of the term. Disclosure using any alternative definition will trigger a Staff comment on review.

44 The phrase “designed or operated” derives from the text of the required Section 302 certification. See Item 601(b)(31)(i) of Regulation S-K (referring to the “design or operation of internal control over financial reporting”).

45 The Staff has permitted this disclaimer only on the condition that the disclosure contain an express statement regarding whether the issuer’s controls and procedures are in fact effective at the reasonable assurance level. See Adopting Release at 22 (recognizing that “some companies have indicated that disclosure controls and procedures are designed only to provide ‘reasonable assurance’ that the controls and procedures will meet their objectives” and that the Staff has required such companies to “set forth, if true, the conclusions of the principal executive and principal financial officer that the disclosure controls and procedures are, in fact, effective at the ‘reasonable assurance’ level”). Similarly, for companies disclosing that there is “no assurance” that disclosure controls and procedures will operate effectively under all circumstances, the Staff requires clarification that “the disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives” and express disclosure, if true, that the principal executive and principal financial officers have concluded “that the controls and procedures are, in fact, effective at the ‘reasonable assurance’ level.” Id.

46 The PCAOB recognizes, in paragraph 16 of Auditing Standard No. 2, that internal control over financial reporting is “subject to lapses in judgment and breakdowns resulting from human failures.”

47 Consider including, if appropriate, additional disclosure regarding the nexus between the material weakness and internal control over financial reporting. Disclosure controls and procedures require timely disclosure of financial statements in compliance with Regulation S-X, whereas a material weakness refers to a control deficiency, or combination of deficiencies, that results in more than a remote likelihood that a material misstatement of the registrant’s annual or interim financial statements will not be prevented or detected. As a result, a material weakness in internal control over financial reporting during a given
Changes in Internal Control over Financial Reporting

Management has evaluated, with the participation of our chief executive officer and chief financial officer, whether any changes in our internal control over financial reporting that occurred during our last fiscal quarter have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. Based on the evaluation we conducted, management has [concluded that no such changes have occurred] [implemented changes in __________ as a result of __________].

reporting period usually means that disclosure controls and procedures were not effective during that reporting period. See supra note 11. For the interaction between disclosure controls and procedures, on the one hand, and internal control over financial reporting, on the other hand, see supra note 16.

48 For the Item 308(c) evaluation of changes internal control over financial reporting, “it is unnecessary to specify a date for the quarterly evaluation,” in contrast to the Item 307 evaluation of disclosure controls and procedures, which must be made “as of the end of the period covered by this report.” See Adopting Release at 21; Items 307 and 308(c) of Regulation S-K.

49 For Item 9A of Form 10-K, this is the fourth fiscal quarter of the year covered by the Form 10-K. See Item 308(c) of Regulation S-K.

50 The management report must disclose any change in the issuer’s internal control over financial reporting identified in connection with the evaluation required by Rules 13a-15(d) and 15d-15(d) that occurred during the issuer’s last fiscal quarter (the fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting. Item 308(c) of Regulation S-K. Most issuers have been providing the disclosure described under Item 308(c), despite confusion over its effective date. Compare Adopting Release at 1 (stating that an issuer “must begin to comply with the requirements regarding evaluation of any material change to its internal control over financial reporting in its first periodic report due after the first annual report required to include a management report on internal control over financial reporting” (emphasis added)) with Adopting Release at 30 (stating that Item 308(c) of Regulation S-K, “requiring disclosure regarding certain changes in internal control over financial reporting,” became effective as of Aug. 14, 2003). See also FAQ 9 (explaining that the Staff “would welcome disclosure of all material changes to controls, whether or not made in advance of the compliance date of the rules under Section 404 of the Sarbanes-Oxley Act,” but “would not object if a registrant did not disclose changes made in preparation for the registrant’s first management report on internal control over financial reporting” provided that no material weakness is identified).

51 Depending on the circumstances, issuers may need to disclose the reasons for changes that occurred during a fiscal quarter. Adopting Release at 21 (“Although the final rules do not explicitly require the company to disclose the reasons for any change that occurred during a fiscal quarter, or to otherwise elaborate about the change, a company will have to determine, on a facts and circumstances basis, whether the reasons for the change, or other information about the circumstances surrounding the change, constitute material information necessary to make the disclosure about the change not misleading.” (citing Rules 10b-5 and 12b-20)).
ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures
As required by Rules 13a-15 and 15d-15 under the Securities Exchange Act of 1934, management has evaluated, with the participation of our chief executive officer and chief financial officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Disclosure controls and procedures refer to controls and other procedures designed to ensure that information required to be disclosed in the reports we file or submit under the Exchange Act is recorded, processed, summarized, and reported, within the time periods specified in the rules and forms of the Securities and Exchange Commission. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in our reports that we file or submit under the Exchange Act is accumulated and communicated to management, including our chief executive officer and chief financial officer, as appropriate to allow timely decisions regarding our required disclosure. In designing and evaluating our disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management was required to apply its judgment in evaluating and implementing possible controls and procedures.

Our chief executive officer and chief financial officer have concluded, based on this evaluation, that as of __________, the end of the period covered by this report, our disclosure controls and procedures were [effective at a reasonable assurance level] [not effective at a reasonable assurance level as a result of __________].

Changes in Internal Control over Financial Reporting
Management has evaluated, with the participation of our chief executive officer and chief financial officer, whether any changes in our internal control over financial reporting that occurred during our last fiscal quarter have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. Based on the evaluation we conducted, management has [concluded that no such changes have occurred] [implemented changes in __________ as a result of __________].
REPORTING COMPANY RISK FACTOR DISCLOSURE

EXPLANATORY NOTE
The following disclosure template sets forth a model risk factor for a reporting company that has identified a material weakness in its internal control over financial reporting. The risk factor contains a cross-reference to Item 9A of Form 10-K or Item 4 of Form 10-Q, as applicable, in which the reporting company should provide complete disclosure of the relevant facts and circumstances relating to the material weakness as described in the Item 9A and Item 4 templates contained in this chapter.

MATERIAL WEAKNESS RISK FACTOR

We have had [a] material weakness[es] in internal control over financial reporting in the past and cannot assure you that additional material weaknesses will not be identified in the future. Our failure to implement and maintain effective internal control over financial reporting could result in material misstatements in our financial statements which could require us to restate financial statements, cause investors to lose confidence in our reported financial information and have a negative effect on our stock price.

During the past _________, [management has] [our independent registered public accounting firm has] [management and our independent registered public accounting firm have] identified [a] material weakness[es] in our internal control over financial reporting as defined in the [Public Company Accounting Oversight Board’s Auditing Standard No. 2] that affected our financial statements for the _________ period ended _________. See “Item [9A] [4]. Controls and Procedures.”

The material weakness[es] in our internal control over financial reporting [during the past _________] related to _______. [If a restatement resulted from the material weakness, include the following sentence:] [The net restatement adjustments resulting from these errors affected our prior year results by [increasing] [decreasing] our _________ by $___ million, or ___%, [increasing] [decreasing] our _________ by $___ million, or ___%, and [increasing] [decreasing] our _________ by $___ million, or ___%].

We cannot assure you that additional significant deficiencies or material weaknesses in our internal control over financial reporting will not be identified in the future. Any failure to maintain or implement required new or improved controls, or any difficulties we encounter in their implementation, could result in additional significant deficiencies.

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52 The risk factor contained in a periodic report should cross-reference Item 9A of Form 10-K or Item 4 of Form 10-Q, as applicable, containing the registrant’s detailed discussion of the material weakness and other matters relating to disclosure controls and procedures and internal control over financial reporting.

53 The risk factor should recite only the facts necessary to provide a brief context to the risk of future material weaknesses. Rather than listing the specific material weaknesses in detail, the risk factor should summarize the material weaknesses and describe their impact on the issuer’s financial statements in terms that an investor without financial or accounting experience would understand. More comprehensive discussion of the accounting details can appear in the MD&A, which the risk factor may cross-reference.
or material weaknesses, cause us to fail to meet our periodic reporting obligations or result in material misstatements in our financial statements. Any such failure could also adversely affect the results of periodic management evaluations and annual auditor attestation reports regarding the effectiveness of our internal control over financial reporting required under Section 404 of the Sarbanes-Oxley Act of 2002 and the rules promulgated under Section 404. The existence of a material weakness could result in errors in our financial statements that could result in a restatement of financial statements, cause us to fail to meet our reporting obligations and cause investors to lose confidence in our reported financial information, leading to a decline in our stock price.

[Depending on the type of material weakness and the financial statement impact, if any, associated with the material weakness, the reporting company’s MD&A disclosure should also include a discussion of the facts and circumstances surrounding the material weakness as well as any known financial statement impact. See “Insert for Management’s Discussion and Analysis” in the following section.]
EXPLANATORY NOTE

The following disclosure template sets forth a model risk factor and MD&A narrative concerning a registrant’s history of ineffective internal control over financial reporting.

MATERIAL WEAKNESS RISK FACTOR

We have had [a] material weakness[es] in internal control over financial reporting in the past and cannot assure you that additional material weaknesses will not be identified in the future. Our failure to implement and maintain effective internal control over financial reporting could result in material misstatements in our financial statements which could require us to restate financial statements, cause investors to lose confidence in our reported financial information and have a negative effect on our stock price.

During the past __________, [management has] [our independent registered public accounting firm has] [management and our independent registered public accounting firm have] identified [a] material weakness[es] in our internal control over financial reporting as defined in the [standards established by the American Institute of Certified Public Accountants] [Public Company Accounting Oversight Board’s Auditing Standard No. 2] that affected our financial statements for the __________ period ended __________. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations — Internal Control over Financial Reporting.”

The material weakness[es] in our internal control over financial reporting [during the past __________ related to __________. [If a restatement resulted from the material weakness, include the following sentence:] [The net restatement adjustments resulting from these errors affected our prior year results by [increasing] [decreasing] our __________ by $___ million, or ___%, [increasing] [decreasing] our __________ by $___ million, or ___%, and [increasing] [decreasing] our __________ by $___ million, or ___%].

We cannot assure you that additional significant deficiencies or material weaknesses in our internal control over financial reporting will not be identified in the future. Any failure to maintain or implement required new or improved controls, or any difficulties we encounter in their implementation, could result in additional significant deficiencies or material weaknesses, cause us to fail to meet our periodic reporting obligations, or result in material misstatements in our financial statements. Any such failure could also

54 In an initial public offering, the issuer will have been subject to AU Section 325, Communication of Internal Control Related Matters Noted in an Audit, rather than Public Company Accounting Oversight Board in Auditing Standard No. 2.

55 The risk factor should recite only the facts necessary to provide a brief context to the risk of future material weaknesses. Rather than listing the specific material weaknesses in detail, the risk factor should summarize the material weaknesses and describe their impact on the issuer’s financial statements in terms that an investor without financial or accounting experience would understand. More comprehensive discussion of the accounting details can appear in the MD&A, which the risk factor may cross-reference.
adversely affect the results of periodic management evaluations and annual auditor attestation reports regarding the effectiveness of our internal control over financial reporting required under Section 404 of the Sarbanes-Oxley Act of 2002 and the rules promulgated under Section 404. The existence of a material weakness could result in errors in our financial statements that could result in a restatement of financial statements, cause us to fail to meet our reporting obligations and cause investors to lose confidence in our reported financial information, leading to a decline in our stock price.

INSERT FOR MANAGEMENT’S DISCUSSION AND ANALYSIS

Internal Control over Financial Reporting

Overview. We have had material weaknesses in internal control over financial reporting in the past. In connection with the audit of our _____ fiscal year[s], our [management] [independent registered public accounting firm] [management and our independent registered public accounting firm] identified matters involving our internal control over financial reporting that constituted material weaknesses as defined by the [American Institute of Certified Public Accountants under AU Section 325] [Public Company Accounting Oversight Board in Auditing Standard No. 2],\textsuperscript{56} pursuant to which:

\begin{itemize}
  \item material weaknesses are defined as reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by errors or irregularities in amounts that would be material in relation to the consolidated financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions; and
  \item reportable conditions are defined as matters representing significant deficiencies in the design or operation of internal control that, in the judgment of our independent registered public accounting firm, could adversely affect our ability to initiate, record, process, and report financial data consistent with our management’s assertions in our consolidated financial statements.
\end{itemize}

These definitions in AU Section 325 are consistent with the definitions of significant deficiency and material weakness as defined by the Public Company Accounting Oversight Board in Auditing Standard No. 2. AS 2 contains the requirements for compliance with Section 404 of the Sarbanes-Oxley Act of 2002. Unlike AS 2, however, under which internal control over financial reporting is considered at year-end, the AICPA standards involve the assessment of reportable conditions and material weaknesses over the periods under audit.

We are committed to maintaining effective internal control over financial reporting to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of financial statements for external purposes in accordance with GAAP. Our accounting personnel report regularly to our audit committee on all accounting and financial matters. In addition, our audit committee actively communicates with and

\textsuperscript{56} See supra note 54.
oversees the engagement of our independent registered public accounting firm. [Based on the actions we have taken to date to enhance the reliability and effectiveness of our internal control over financial reporting, our management believes that there is no material weakness in our internal control as of the date of this prospectus because we have remediated the underlying causes of the identified material weaknesses.] However, our independent registered public accounting firm has not evaluated the measures we have taken to address the _____ material weaknesses [that we] identified [by our independent registered public accounting firm in its management letter in connection with the audit of our financial statements for 20___ and will not audit our internal control over financial reporting until 20___.

In the _____ quarter of 20___, management commenced a review of internal control over financial reporting and related accounting processes and procedures for purposes of complying with Section 404 of the Sarbanes-Oxley Act. This review is ongoing. Under Section 404, management would have to evaluate, and our independent registered public accounting firm would have to opine on the effectiveness of, internal control over financial reporting beginning with our Annual Report on Form 10-K for the year ending December 31, 20___, due to be filed in March 20___. We expect to hire an independent consulting firm in 20___ with expertise in Section 404 compliance to assist us in satisfying our obligations under Section 404 with respect to our internal control over financial reporting.

As of the date of this prospectus, our management believes that our internal control over financial reporting is effective at a reasonable assurance level. However, internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives due to its inherent limitations because internal control involves human diligence and compliance and is subject to lapses in judgment and breakdowns from human failures. Nonetheless, these inherent limitations are known features of the financial reporting process, and it is possible to design into the process safeguards to reduce, though not eliminate, this risk.

[Although we believe we have remediated the material weaknesses that have been identified in connection with the audit of our 20___ financial statements, we] [We] may in the future have additional material weaknesses in our internal control over financial reporting. Failure to implement and maintain effective internal control over financial reporting could result in material misstatements in our financial statements. See “Risk factors.”

**Material Weaknesses in 20___.** In __________, in connection with the audit of our financial statements for the three years ended December 31, 20___, our independent registered public accounting firm identified errors in __________. These errors related to __________. The control deficiencies related to these errors were determined to constitute a material weakness in our internal control over financial reporting. The material weakness related to our lack of procedures designed to ensure the proper recording of expenses and assets under the full accrual method of accounting in accordance with GAAP. In most cases, the errors resulted from __________. We believe
these control deficiencies occurred because __________ [we did not maintain sufficient staffing of our accounting department and did not have accounting management personnel with adequate training and familiarity with the application of GAAP and policies and procedures relating to internal control over financial reporting]. In addition, we had not at that time established sufficient internal control over financial reporting designed to ensure the proper functioning of the financial statement close process.

Upon being informed of the material weakness, our management and the audit committee of our board of directors took steps to correct the errors that had been identified and to remediate the material weakness relating to the identified accruals and our financial statement close process:

[See Appendix A.]

Based upon these changes, we believe that the material weaknesses relating to __________ were remediated in 20___. [The management letter we received from our independent registered public accounting firm in connection with the audit of our financial statements for 20___ did not include a material weakness relating to these issues.]

[In connection with re-closing our 20___, 20___, and 20___ financial statement periods, we restated our 20___ and 20___ financial statements. The 20___ restatement adjustments resulted in a net decrease of $___ million to our net loss in 2002, including an adjustment of $___ million relating to __________. The other restatement adjustments netted to approximately $___ million and related to: __________ of $___ million; __________ of $___ million; and __________ of $___ million]. Restatement adjustments to 200__ amounted to an increase in net loss for 200__ totaling less than $___ million and related primarily to timing adjustments. The restatement also resulted in a cumulative increase in total assets of $___ million and a cumulative decrease in total liabilities of $___ million as of December 31, 20___.]

We implemented the __________ in the _____ quarter of 20___ prior to our closing the December 31, 20___ financial statements. [We also established steps in our monthly closing process to improve our internal control over financial reporting.] These steps include [designing appropriate standard monthly journal entries to account for this activity, training accounting personnel on the proper accounting treatment, and instituting review and approval controls in this area]. Management believes that these steps, which we took during the fourth quarter of 20___, had the effect of remediating this material weakness prior to December 31, 2004.

Conclusion. In addition to remediating the material weaknesses that have been identified, we have [established formal, documented accounting policies and procedures to improve our internal control over financial reporting to provide reasonable assurance regarding the reliability of our financial reporting]. These policies and procedures require: [two levels of approval for inputs to, and outputs from, our financial accounting system; detailed
minimum documentation requirements for cash disbursements, journal entries, account reconciliations and other accounting-related documents; standardized organization and maintenance of accounting files; enhanced accounts payable procedures designed to effectively monitor invoices that are distributed for internal approval; improved tracking of assets and their in-service dates for purposes of depreciation; and procedures for deploying the existing purchase order system to identify unbilled goods and services from vendors. In addition, all approvals within the process require the dated signature of at least two persons from our accounting management]. Management believes that we have enhanced the reliability and effectiveness of our internal control over financial reporting such that our internal control over financial reporting is effective at a reasonable assurance level as of the date of this prospectus.