

PERVASIVE 229

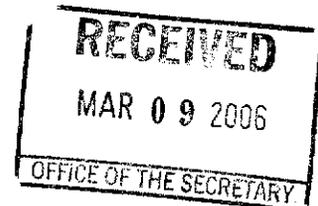
March 7, 2006

Facsimile: 202-772-9324, Attn: Federal Advisory Committee Management Officer

The Honorable Christopher Cox
Chairman
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1070

Subject: Comments on File Number 265-23

Dear Chairman Cox:



I am writing to you on behalf of Pervasive Software Inc. (NASDAQ: PVSW). My current position with the Company is Director, President and Chief Executive Officer effective January 2006. Prior to that, I served the Company as Chief Financial Officer since July 2001. Prior to joining Pervasive in 1994, I was a CPA in the Audit department of KPMG Peat Marwick for more than 12 years.

Pervasive Software is a micro-cap company with trailing twelve-month revenues of \$48M and a market capitalization of \$96M as of March 6, 2006. We are a software development company incorporated in January 1994 and became a public company with our initial public offering in September 1997. We employ 230 individuals throughout the world, 160 of which are located in our home office in Austin, Texas.

Pervasive's fiscal year end is June 30 and as such, we completed our first SOX Section 404 Audit for the fiscal year ended June 30, 2005 (with clean, unqualified audit reports) and will soon begin incurring outside auditor costs related to our Section 404 audit for the 2006 fiscal year.

With cash and securities of approximately \$41M, we have an enterprise value of \$55M, or slightly more than 1.1x revenues. While we are a profitable company, we are only slightly so after implementing Stock-based compensation rules of FASB Statement 123R effective July 1, 2005. In the first two quarters following implementation of FASB 123R, we have generated in total \$348 thousand in GAAP-basis operating income. These numbers are important for the purpose of understanding the impact of SOX implementation costs on the Company, and are explained in detail below.

As a CPA, CFO and now CEO, I am intimately familiar with the Sarbanes-Oxley Act of 2002 and related regulations and guidance issued over the past few years, as well as the ongoing activities of the SEC Advisory Committee on Smaller Public Companies (ACSPC) and the Committee's Exposure Draft in Internal Control recommendations.

With that background, I would like to offer the following comments for consideration by the Commission:

- (1) Support for the ACSPC's work. I am in support of the majority of the ACSPC's recommendations in its Exposure Draft on Internal Control. For many of the reasons cited below, I do believe that the ACSPC should adopt a permanent exemption from Section 404 and, in particular, the auditor attestation provisions of Section 404, for

microcap companies, i.e., I would strongly encourage deletion of the proviso, "unless and until a framework for assessing internal control over financial reporting for microcap companies is developed that recognizes the characteristics and needs of those companies..."

- (2) Time is of the essence. I hope that if the decision is made to make changes, that the decision is made (and the changes are implemented) quickly. While it is too late for calendar year-end companies to be affected by a modified set of rules, there are many, many fiscal year-end companies needing relief.
- (3) Pervasive Software changed external audit firms effective September 2005. The primary driver for this change was the COST associated with our SOX 404 audit. The incumbent Firm refused to provide a fixed fee estimate for year two 404 work, but the new Firm was willing to provide a "not to exceed" fee proposal for the regular audit and 404 audit combined. The uncertainty of the incumbent Firm's proposal in terms of cost was too great for us to accept based on the experience with that Firm in year one. In addition, the incumbent Firm's expectation setting regarding fees represented an increase in their "expected" rate per hour in year one, which in the end would have translated into INCREASED 404 Audit costs in year two.
- (4) When I speak with current or prospective investors, their questions are generally around the costs of 404 compliance. Not once have I fielded a question about what we are doing to comply and the results of our compliance.
- (5) "Catch 22" situations were frequent in our year one 404 audit. For example, as a small company, the CFO is expected to be very knowledgeable and extremely hands-on in the Finance and Accounting function. Yet, many of the conversations surrounding 404 Compliance involved discussions regarding whether the CFO was too involved in various processes. A CFO being less involved in a small company setting would naturally translate to yet another incremental cost for 404 Compliance that being increased staff. Small company CFOs by their nature are much more likely to roll up their sleeves and engage with the process itself, as opposed to large company CFOs who by necessity, have to rely to a much greater extent on the functioning of the process itself. Even with the investment of additional staff, a small company CFO will very likely continue to dig in just as deeply as they have in the past in order to derive that personal comfort level prior to signing the certifications (therefore, likely to be some inefficient duplicity of effort).
- (6) As a small public company, we are much more concerned about the utility of the outside Audit costs incurred for 404 compliance than we are with our internal investment of time in designing, documenting, and monitoring our processes. The good that has come from year one 404 is the opportunity to re-examine ourselves in what we do, and how we do it. That has been a beneficial exercise.
- (7) However, the ongoing outside 404 Audit is not cost effective by any stretch (in year one or year two for that matter). Our year one 404 audit costs were more than 200% of our historical regular audit costs, a whopping 4% of revenue, and more than 25% of our expected post-FAS123R Operating Income (based on annualizing results from our most recent two fiscal quarters). In year two, even with the cost savings provided by the new Firm as proposed, is still expected to be around 150% of our regular annual audit cost.

Why is this?

First, in my experience as a CFO and Finance executive (11 years) and my experience as an Outside Auditor (12 years), I can safely say that the smaller the entity being audited, the less economy provided by a "controls" based audit versus a "substantive" audit. Financial Audits of smaller companies tend to be very "substantive" in nature in

that most, if not all, of the material transactions or sets of transactions can be more affordably audited 100%. In small companies, I believe financial audits will forever be primarily substantive in nature, but the 404 audit will be primarily compliance in nature, resulting in duplicative and inefficient effort. This will be true in the small company setting whether we are talking about year one, year two, year three... year N of 404.

Second, the "economy" afforded by an "integrated" audit approach (regular audit and 404 compliance audit) diminishes greatly in smaller company settings. Yet, the law says we MUST use our external audit firm for both the financial audit and the 404 audit. This legislated vendor selection does not allow the free market (competition for services) to work in small company situations where there is so much redundancy in the effort to achieve the primary objective of shareholder confidence in reported results and related disclosures.

I could talk and write for hours on the topics above, but in respect of the Commission's time as well as mine, I have confined my primary comments to those listed above. I hope the Commission will weigh heavily the recommendations of the ACSPC. This committee is comprised of many public company managers who are living through the implementation of Section 404.

I can appreciate the legislative points of view. I am concerned about the Auditing Industry point of view. I have a sense for the microcap investor point of view. I have an intimate sense for the microcap Company point of view. The intent of the SOX Act and Section 404 are well intended, but the cost/benefit for microcap companies is completely upside down.

Respectfully,
Pervasive Software Inc.



John Farr
President and CEO