UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

OFFICE OF THE
INVESTOR ADVOCATE

May 23, 2016

The Honorable Paul Ryan
Speaker of the House
U.S. House of Representatives
H-232, Capitol Building
Washington, D.C. 20515

The Honorable Nancy Pelosi
Minority Leader
U.S. House of Representatives
H-204, Capitol Building
Washington, D.C. 20515

Dear Speaker Ryan and Minority Leader Pelosi,

H.R. 4139, cited as the "Fostering Innovation Act of 2015," is ill-advised, and I urge Members of Congress to vote against it.[1] The bill would allow smaller public companies to avoid the auditor attestation requirement of the Sarbanes-Oxley Act for up to 10 years following an initial public offering.

In a small company, as in a large one, it is management's job to maintain a system of internal controls to help ensure that the financial statements are reliable. A key reform of the Sarbanes-Oxley Act, which followed on the heels of the Enron implosion and other accounting scandals that wreaked havoc on American investors, was to require that a company's auditor attest to management's assessment of the effectiveness of its internal control over financial reporting. This "second set of eyes" helps to identify potential risks of material misstatements and is designed to prevent or detect fraud. Unfortunately, H.R. 4139 would chip away further at the requirement for a second set of eyes, even though auditor attestation enhances reliability of financial reporting for investors, which has been shown to reduce the cost of capital for businesses.

Credible empirical research has established that both investors and companies benefit from having auditors attest to the effectiveness of internal controls. For example, institutional investors rely on the auditor's opinion. Auditor testing uncovers more deficiencies than does

[1] Pursuant to 15 U.S.C. § 78d(g)(4), the Investor Advocate at the U.S. Securities and Exchange Commission is required to identify problematic products and practices that impact investors, and to recommend to Congress any legislative, administrative, or personnel changes that may be appropriate to mitigate problems identified and to promote the interests of investors. The views expressed herein are my own and do not necessarily reflect the views of the Commission, the Commissioners, or staff of the Commission.

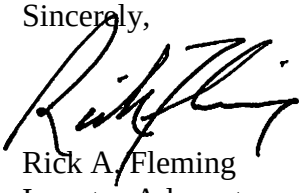
management's assessment alone. Moreover, there is a positive correlation between a material weakness in internal control and the future revelation of fraud. Indeed, companies with more serious control problems tend to be smaller, less mature, growing, or rapidly changing. All of this academic research is described at length in the testimony of University of Tennessee professor Joseph V. Carcello[2] on this bill before the Subcommittee on Capital Markets and Government Sponsored Enterprises of the House Financial Services Committee. In addition, a 2011 study published by the staff of the U.S. Securities and Exchange Commission[3] found that companies that do not have an auditor attestation tend to have significantly more material weaknesses in their internal controls and more financial restatements.

Since the adoption of the Sarbanes-Oxley Act in 2002, several steps have already been taken to significantly reduce the burden on smaller companies from the auditor attestation requirement in Section 404(b). In 2007, for example, the SEC and the Public Company Accounting Oversight Board took steps to reduce the costs of 404(b) compliance. Later, the Dodd-Frank Act exempted approximately 60 percent of companies from this requirement, and the JOBS Act waived the requirement for emerging growth companies for up to five years. HR 4139 would extend this exemption for up to 10 years for certain issuers, and I believe it is a step too far.

Aside from weakening an important investor protection, H.R. 4139 further compounds the complexity of securities law reporting requirements by creating yet another category of issuers. The development of scaled reporting requirements has resulted in multiple overlapping issuer categories, each eligible for different rules, and that complexity itself adds to the cost of raising capital.

In short, the independent audit of internal controls provides important protections to investors and the companies in which they invest. It strengthens internal controls, prevents fraud, and promotes confidence in U.S. capital markets. I oppose H.R. 4139 because it would further deteriorate the benefits of Section 404, and I strongly encourage you to oppose it as well. Please call me at (202) 551-3302 if you have any questions.

Sincerely,



Rick A. Fleming
Investor Advocate

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[2] *See* Legislative Proposals to Improve the U.S. Capital Markets: Hearing Before the H. Subcomm. on Capital Markets and Government Sponsored Enterprises of the H. Comm. of Financial Services, 114th Congress 5-7 (statement of Joseph V. Carcello, Ph.D., EY and Business Alumni Professor, University of Tennessee, Knoxville), available at: http://financialservices.house.gov/uploadedfiles/hhrg-114-ba16-wstate-jcarcello-20151202.pdf.

[3] *See* "Study and Recommendations on Section 404(b) of the Sarbanes-Oxley Act of 2002 For Issuers With Public Float Between $75 and $250 Million" (April 2011), available at: https://www.sec.gov/news/studies/2011/404bfloat-study.pdf.