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Via Electronic Mail

The Honorable Christopher Cox, Chairman
U.S. Securities and Exchange Commission
Attn: Nancy M. Morris, Secretary
100 F Street, NE Washington, DC 20549
Electronic Address: rule-comments@sec.gov

The Honorable Mark W. Olson, Chairman
Attn: Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 20006-2803
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Re: SEC File Number S-7-24-06; Management's Report on Internal Control Over Financial Reporting (71 Fed. Reg. 77,635); PCAOB Release No. 2006-007; Proposed Auditing Standard

The American Stock Exchange ("Amex," or the "Exchange") appreciates the opportunity to comment on the Proposed Rule for Management's Report on Internal Control over Financial Reporting. We commend the Commission and the Public Company Accounting Oversight Board ("PCAOB") for this undertaking aimed at tailoring regulation implementing Section 404 of the Sarbanes-Oxley Act of 2002 ("SOX"). In the period since SOX was enacted, there has been widespread recognition that the impact of regulation in terms of compliance burden and increased cost is proportionally much greater for smaller companies. Because rulemaking by the Commission and the PCAOB is closely linked in its impact on public companies, the Exchange offers its comments in light of proposed rules issued by both bodies.

The Amex is the only national exchange with a primary focus on smaller companies. We have a strong corporate interest in seeing these companies succeed on a U.S. exchange. We have previously testified before Congress and the Commission on the need for modification of Section 404 to achieve badly needed regulatory clarity and reform. The Sarbanes-Oxley legislation and the rules associated with it were established in 2002 to improve corporate governance and internal controls after a wave of accounting scandals that tarnished the image of corporate America. There is real value in having legislation that protects the investing public from corporate malfeasance. The new regulations, however, made no distinction between a fifty billion-dollar large-cap company and a 75 million dollar small-cap company. The failure to recognize those differences has made it extremely difficult for smaller companies to compete and grow in this current regulatory environment. In addition to problems faced by domestic companies, the lack of differentiation also places Amex and other U.S. exchanges at a steep competitive disadvantage not only in seeking listings of foreign based companies based in countries with markets to which SOX does not apply, but also in seeking listings of U.S. companies concerned about the additional costs and regulatory burden in the U.S. relative to competing non-U.S. exchanges. Foreign exchanges have used the SOX compliance burden as a key message in competing against U.S. markets for new listings.

The Exchange has firsthand experience with the impact of SOX on smaller public companies. Even though some of the smallest public companies are still exempt from the full requirements of complying with Section 404 due to their status as non-accelerated filers, more than a dozen companies have voluntarily delisted from the Exchange over the past year. While all exchanges experience delistings when companies fail to maintain exchange listing standards, the companies in this particular group have voluntarily delisted, often citing the expenses associated with SOX compliance as a significant reason for leaving the Exchange for the private equity market, pink sheets, or listing on a non-U.S. exchange. Obviously, this also largely removes them from SEC regulatory oversight. While the voluntary delistings are troubling, of even greater concern is the number of companies that may have been considering listing on a domestic exchange, but instead may be choosing non-U.S. capital markets where SOX does not apply. This situation has potentially serious implications for U.S. capital markets' ability to maintain their global leadership in increasingly competitive global markets. The Amex believes in having a strong regulatory environment, but one that allows competition and innovation to thrive.

Amex Response to SEC and PCAOB proposals

Our response to the new proposed guidelines will focus on the impact that they will have on the types of companies that list on our exchange as well as the mid-cap companies that previously favored raising capital in the U.S. capital markets but may have pursued alternate solutions in lieu of incurring the high costs of implementation and ongoing compliance with the requirements of SOX Section 404. We have stated previously that the provisions of Section 404 as well as the PCAOB's AS2 were unduly onerous for smaller companies. Among the potential solutions proposed in the past are the following:

- Exempting small companies (\$75 million or less in market capitalization) from the requirements of SOX 404
- Eliminating the duplicate audit requirements of AS2 whereby the external auditors are required to report on management's Internal Control over Financial Reporting (ICFR) as well as opining separately on the overall effectiveness of ICFR
- Applying the requirements of 404 on an alternating cycle rather than on an annual basis
- Scaling down the requirements of the legislation for smaller companies to reflect the different control environment that they maintain compared with their larger counterparts
- In lieu of modifying the prevailing legislation and auditing guidance, providing specific guidelines, checklists and examples to aid companies in implementing the requirements, thus eliminating the guesswork and expansive scope that many companies experienced in designing their management assessment process.

Using the potential solutions listed above as a backdrop, we examined both the SEC's proposals and those of the PCAOB("Rulemaking Docket 021: Proposed Auditing Standard – An Audit of Internal Control Over Financial Reporting that is Integrated with an Audit of Financial Statements") to determine the degree to which they address the concerns that generated the proposed solutions listed above.

- The SEC’s proposal in Release 33-8762 does not provide an exemption for small companies. The only concession made by the Commission was to extend the compliance date for management assessment of ICFR for non-accelerated filers ‘...until it files an annual report for its first fiscal year ending on or after December 15, 2007.’ The first external auditor attestation of ICFR would be required for fiscal years ending on or after December 15, 2008. Since this is merely an extension and not a waiver, it is unlikely to have any significant impact on the decisions by companies to proceed with a public offering of their securities. In the PCAOB’s Rulemaking Docket 021 there was no mention of a small company exemption.
- Both the SEC and the PCAOB have made progress with respect to the elimination of the duplicate audit requirement. In a separate proposal, the Commission is seeking public comment on an amendment to acknowledge that the auditor will now opine only on the effectiveness of ICFR, thereby eliminating the opinion on **management’s** assessment. Likewise, the PCAOB’s proposed new standard would eliminate the requirement for the auditor to report on **management’s** assessment. Neither proposal would eliminate management’s responsibility for conducting an annual assessment of ICFR. The SEC guidance is intended to provide flexibility, but is lacking specific guidance and examples, while the PCAOB revised standard is very prescriptive, containing specific bullet point standards by which auditors will be directed to measure and appraise management’s ICFR process. The ambiguity between the SEC and PCAOB approaches must be addressed and reconciled. The SEC and the PCAOB must work together to harmonize the SEC’s management guidance and the PCAOB’s revisions to the audit standard. To better assist management in constructing and evaluating ICFR, the SEC guidance should provide more information in the form of examples and more specific information that management can utilize in its process of development and evaluation of ICFR.
- Neither proposal addresses an alternating cycle for ongoing compliance. An alternating cycle would remove the “all or none” gauntlet that faces smaller companies and could effectively establish a process that could still be sustainable in the “off cycle” years with a reduction in scope and formality.
- Scalability was addressed by both the SEC and the PCAOB in their proposals, albeit from two different perspectives. The SEC recommends that management focus on employing a top-down, risk-based approach. While the SEC’s proposal indicated that management is still required to use a framework such as COSO in evaluating ICFR, it stressed the fact that management’s objective should be to identify only those controls (including entity level controls) necessary to adequately address the risk of material misstatement in the financial statements. The SEC also made clear that management and the auditor may have different testing approaches, but still stipulated that management’s evaluation of deficiencies should be based on both quantitative and qualitative factors. Unfortunately, the SEC proposal does not provide a definition of “risk-based,” nor does it provide examples of a risk based approach for management to use in the development of their ICFR evaluative process. The lack of additional information and guidance could well result in a continuation of the current problem of spending an excessive amount of time and financial resources attempting to take a prudent, conservative approach to unspecific guidelines in order to “fill in the blanks.” The PCAOB proposal is primarily focused on

the auditor's role and provides materiality guidelines as well as reinforcing the concept of a risk-based approach. The proposal also links the measures of materiality for the ICFR audit with the financial statement audit. It offers principles to help scale the audit to smaller and less complex companies.

- The SEC's proposal stops short of providing a more specific roadmap for companies to follow. It is a principles-based approach that stresses the use of management's judgment in making its assessment of ICFR. We believe that the Commission should provide more specific guidelines and examples for identification and documentation of controls, the scope to be applied to the program of testing and the remediation of control weaknesses. In the past, companies have struggled to implement a process that is compliant while achieving a streamlined, efficient approach. Specific guidelines would ensure that management's program is tailored to the size and complexity of the company. The PCAOB has provided general guidelines to auditors which, when followed should enable them to tailor their approach to each individual client. These should result in a streamlined approach and ultimately yield cost savings.

The SEC and the PCAOB are to be commended for their efforts to address the widespread concerns arising from implementing SOX Section 404. The proposals represent a step in the right direction. However, as currently delineated, they risk falling short of being significant enough to reverse the trends that are presently developing in the U.S. capital markets in terms of companies seeking to avoid having to comply with SOX by accessing capital through private equity or non-U.S. capital markets. We would encourage the Commission and the PCAOB to re-evaluate these proposals in light of public comments received and provide a more dramatic change in requirements as well as more comprehensive guidance that includes examples for management to use in constructing and assessing their ICFR regime. We believe that the most significant change that could be implemented would be the elimination of the external audit of internal control and place the focus upon the opinion on management's assessment. This would reduce audit costs across the board without relieving management of its obligation to maintain, document and evaluate the effectiveness of its internal control environment.

Sincerely,



Neal L. Wolkoff
Chairman and CEO