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December 6, 2010

Elizabeth M. Murphy, Secretary  
U.S. Securities and Exchange Commission  
100 F Street, N.E.  
Washington, D.C. 20549-1090

Re: ICBA's Comments to the SEC Concerning the Study Required by Section 989G(b) of the Dodd-Frank Act Regarding Compliance With Section 404(b) of the Sarbanes-Oxley Act

Dear Ms. Murphy:

The Independent Community Bankers of America<sup>1</sup> ("ICBA") welcomes the opportunity to comment on the Securities and Exchange Commission's study concerning the burden of complying with Section 404(b) of the Sarbanes-Oxley Act of 2002 for companies whose public float is between \$75 million and \$250 million. The study is also looking at whether a complete exemption for such companies from the auditor attestation requirement in Section 404(b) would encourage companies to list on exchanges in the United States in their initial public offerings.

SOX Section 404(a) requires a publicly held company to include in its annual report (1) a statement of management's responsibility for establishing and maintaining an adequate internal control structure and procedures for financial reporting; and (2) management's assessment, as of the end of the company's more recent fiscal year, of the effectiveness of the company's internal control structure and procedures for financial reporting. Section 404(b) requires the company's auditor to attest to, and report on, management's assessment of the effectiveness of the company's internal controls and procedures for financial reporting.

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<sup>1</sup> The Independent Community Bankers of America represents nearly 5,000 community banks of all sizes and charter types throughout the United States and is dedicated exclusively to representing the interests of the community banking industry and the communities and customers we serve. ICBA aggregates the power of its members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever changing marketplace.

With nearly 5,000 members, representing more than 20,000 locations nationwide and employing nearly 300,000 Americans, ICBA members hold \$1 trillion in assets, \$800 billion in deposits, and \$700 billion in loans to consumers, small businesses and the agricultural community. For more information, visit ICBA's website at [www.icba.org](http://www.icba.org).

## ICBA's Comments

As a result of the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act this year, publicly held companies with public float of less than \$75 million are permanently exempt from the auditor attestation requirements of Section 404(b). **ICBA strongly favors extending this exemption to publicly held companies whose public float is between \$75 million and \$250 million.** We believe the evidence is compelling that micro-cap and small-cap companies disproportionately share in the compliance burden and costs of SOX 404, particularly the external audit costs of complying with Section 404(b). Furthermore, these costs far outweigh the benefits.

In a previous letter to the SEC on April 3, 2006, ICBA strongly endorsed the conclusions of SEC Advisory Committee on Smaller Public Companies. That Committee recommended that micro-cap companies with equity capitalizations of \$128 million or less be completely exempted from SOX 404 and small-cap companies with equity capitalizations of between \$128 million and \$787 million be exempted from the external audit requirements of SOX Section 404(b). We agreed with the Advisory Committee's report that with more limited resources, fewer internal personnel and less revenue with which to offset the costs of Section 404 compliance, both micro-cap and small-cap companies are disproportionately impacted by the burdens associated with Section 404 compliance. We said that the benefits of documenting, testing and certifying the adequacy of internal controls, while of obvious importance for large companies, are of less value for micro-cap and small-cap companies, who rely to a greater degree on "tone at the top" and high-level monitoring controls, to influence accurate financial reporting.

Moreover, the SEC Advisory Committee presented strong evidence that the proportionately larger costs for smaller public companies to comply with Section 404 adversely affect their ability to compete with larger public companies and even with foreign competition. This reduction in the competitiveness of U.S. smaller public companies hurts their capital formation ability and, as a result, hurts the U.S. economy.

During this current economic downturn, many publicly held community banks are having a difficult time raising capital and in many cases, have had to postpone or cancel their capital raising plans. The cost and burdens of SEC compliance and in particular, SOX 404 compliance, is not only a drain on the earnings of publicly held community banks but impairs their ability to compete with private banks and raise capital. ICBA's 2005 survey of Section 404 costs for community banks revealed that the average community bank spends \$200,000 and devotes over 2,000 internal staff hours to comply with Section 404. These costs far outweigh the benefits for these small companies. Almost 40% of the average \$200,000 that community banks spent on SOX 404 compliance was due to the external audit expenses or the costs of complying with Section 404(b).

In 2007, the PCAOB issued its Auditing Standard No. 5 and the SEC issued its "Guidance Regarding Management's Report on Internal Control over Financial Reporting Under Section 13(a) or 15(d) of the Securities Exchange Act of 1934" to address the concerns over the costs of SOX 404 compliance and to allow management and the auditors to focus on the internal controls that are needed to adequately address the

risk of a material misstatement of its financial statements. **Despite this guidance, studies continue to show that publicly held companies pay an extraordinary amount to comply with SOX 404.**

For instance, the latest FEI or Financial Executives International study on SOX 404 costs found that at the end of 2007 following the issuance of the SEC guidance, total average cost for Section 404 compliance among the companies that it surveyed was \$1.7 million.<sup>2</sup> While 404 auditor costs declined 5.4% from 2006 as the auditor scope of work narrowed, these costs were offset by a reported five percent increase in the average hourly audit rate charged by auditors. FEI also found that auditor attestation fees paid by accelerated filers in 2007 constituted 23.7% of the accelerated filer's total annual audit fees and averaged \$846,000, representing only a 5.4% decrease from 2006.

In September 2009, the SEC's Office of Economic Analysis issued its 140 page report on the costs of complying with SOX 404<sup>3</sup> after conducting a large web-based survey of publicly held companies over a period from December 2008 to January 2009. The Study found that for companies that were already complying with Section 404(b), the mean total Section 404 compliance cost following the issuance of the SEC guidance was still a staggering \$2.33 million per year. Section 404(b) audit fees were a significant portion of those total costs, amounting to a mean average of \$1,127,325. Even though the overall mean 404 compliance costs had dropped 19% from the pre-guidance cost, for smaller reporting companies, the drop was not as significant. In fact, the Study showed that for filers with public float lower than \$75 million, the mean SOX 404 compliance cost following the issuance of SEC guidance was very high--\$690,000 per year and the mean 404(b) audit cost was \$259,004. From its Study, the SEC generally concluded that smaller publicly held companies have higher SOX 404 compliance costs as a fraction of their asset value.

With respect to the benefits of SOX 404, the Study did show that respondents perceived some benefits from SOX 404 compliance. These included improvement in the quality of the company's internal control structure, the audit committee's confidence in the company's internal controls, and the company's ability to prevent and detect fraud. But the majority of the respondents recognized no effect of Section 404 compliance on the company's ability to raise capital, investor confidence in the company's financial reports, and the company's overall firm value.

Moreover, when respondents were asked in the Study the cost-benefit trade-off of Section 404 compliance, the results were significantly negative. Overall, publicly held companies view the costs of Section 404 compliance as far outweighing the resulting benefits. The feeling was even more pronounced among smaller public companies. When asked if the costs of Section 404 motivated their company to consider going private, among all firms, 16.8% answered that they were very seriously considering it and 27.4% said they were somewhat considering it. However, among smaller firms, 31.5%

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<sup>2</sup> See FEI News Release dated April 30, 2008 entitled "FEI Survey: Average 2007 SOX Compliance Cost \$1.7 Million."

<sup>3</sup> See "Study of the Sarbanes-Oxley Act of 2002 Section 404 Internal Control Over Financial Reporting Requirements" issued by the SEC's Office of Economic Analysis in September, 2009.

said they were seriously considering going private and 38.2% said they were somewhat considering it. Interestingly, when smaller foreign firms were asked if the costs of Section 404 motivated their company to consider delisting from U.S. exchanges, 46.2% said they were very seriously considering it and 30.8% said they were somewhat considering it.

## **Conclusion**

ICBA strongly favors extending the SOX Section 404(b) exemption to publicly held companies whose public float is between \$75 million and \$250 million. The evidence from all SOX 404(b) studies, including the SEC's own study that was released last year, support the conclusion that micro-cap and small cap companies are disproportionately burdened by the costs of complying with SOX 404 and in particular, the auditor attestation requirements of Section 404(b). Furthermore, these costs outweigh the benefits of SOX 404, including an improved internal control structure and the company's ability to prevent or detect fraud. These studies also indicate that despite the 2007 guidance issued by the SEC and the PCAOB's issuance of Auditing Standard No. 5, SOX 404 costs and in particular, 404(b) audit fees remain exceedingly high. Many smaller firms are seriously considering going private and many smaller foreign firms are considering delisting from U.S. exchanges.

ICBA appreciates the opportunity to comment on the SEC study concerning the burden of complying with Section 404(b) of the Sarbanes-Oxley Act of 2002 for companies whose public float is between \$75 million and \$250 million. If you have any questions about our letter, please do not hesitate to contact me at 202-659-8111 or [Chris.Cole@icba.org](mailto:Chris.Cole@icba.org).

Sincerely,  
/s/ Christopher Cole

Christopher Cole  
Senior Vice President and Senior Regulatory Counsel