

Subject: File Number SR-NASDAQ-2013-032  
From: Michael McConnell  
Affiliation: CFO of Digimarc Corporation

I am the Chief Financial Officer of Digimarc Corporation (NASDAQ: DMRC) and would like to summarize our objections to the proposed requirement for all NASDAQ listed companies to establish and maintain an internal audit function. In summary, the proposed rule requiring an internal audit function is unnecessary for a microcap company, is superfluous to an effective SOX program, and is duplicative of the role performed by our Finance department and independent outside auditor.

**An Internal Audit Function is Unnecessary for a Microcap.** We are a small company with a market cap of approximately \$150 million. Our annual revenues are under \$50 million and we have approximately 120 employees, all US based. We have five significant customers that account for a substantial majority (~90%) of our revenue. The business is exceptionally simple, relative to any company that would normally have an internal audit function, and internal audit is simply unnecessary in a microcap company. With strong management involvement and oversight, and good separation of duties, almost everything about our business is known by each member of the Finance team and many of the executive officers, and there is no opportunity for any material fraud, improper behavior or internal impropriety. We believe that establishing an internal audit function (1) adds an unnecessary layer of complexity to operations and oversight, (2) is burdensome and wasteful of corporate assets to the detriment of shareholder value, and (3) provides no additional value (i.e. no return on investment) to shareholders for a company of our size and nature of operations.

**An Internal Audit Function is Superfluous of an Effective SOX Program.** It also provides an unnecessary level of complexity when establishing and assessing the effectiveness of internal controls over financial reporting. We currently have a comprehensive Sarbanes-Oxley program that encompasses risk assessment, testing and evaluation processes that address all key areas that could have a material impact on our internal controls over financial reporting. Our overall plan, testing results and assessment are submitted to the CEO and CFO for approval and certification and are communicated to our Audit Committee, as well as our outside audit firm, on an annual basis. In addition we provide quarterly updates to all of these entities regarding our progress and findings. Where we don't have sufficient internal expertise in performing certain assessments (e.g., IT processes and income taxes), we employ expert firms to assist us in those areas. For the past 5 years of filings with the Securities and Exchange Commission (we were incorporated in our current form in 2008), we have concluded that our internal control over financial reporting was effective as of the end of each year.

Our outside audit firm, KPMG LLP, performs its own assessment and testing and provides an opinion on the effectiveness of our internal controls over financial reporting. Our auditors have reached the same conclusion as management. Internal audit would be a costly repetition of these efforts.

**An Internal Audit Function is Duplicative of the Role Performed by our Finance Area and Independent Outside Auditor.** In a small company, the work of the Finance department includes internal audit and review. Moreover, our independent outside auditors perform an extensive annual audit plus three quarterly reviews, each of which includes substantial independent review of financial reporting, processes, controls and environment. While the Finance department is not "independent" of management and does not report directly to the Audit Committee, KPMG is both independent and is hired by and reports to the Audit Committee. In a microcap, the proposal to add an internal audit function is duplicative of work already performed.

For the above noted reasons, we believe that the proposed rule requiring a NASDAQ-listed company to establish and maintain an internal audit function should be withdrawn in its entirety. To the extent it is not withdrawn, we urge that further assessment be made to address the costs and benefits of this requirement for smaller simpler companies vs. larger more complex NASDAQ listed companies. We suggest certain thresholds be considered in such assessment, such as annual revenues or market capitalization, possibly as high as \$1 billion for each, before the overhead of an internal audit function be imposed on a company.

An alternative might be to allow shareholders to decide whether to require an internal audit function for smaller public companies. For example, as part of this assessment, NASDAQ could require a shareholder vote similar to the "say on pay" proposals currently included in the annual proxy process. Such a vote would provide insight into the value that shareholders would put on an internal audit requirement. We are confident that the shareholders of microcaps would view this requirement as a waste of corporate assets.

Thank you for the opportunity to respond to the proposed requirement.

Michael McConnell  
Executive Vice President and Chief Financial Officer  
Digimarc Corporation