

March 18, 2005
Redwood Shores, CA 94065

Gentlemen:

My thoughts are based on my experience as a small-cap public company chief financial officer and as a 404 internal controls consultant. These views are personal and do not represent any other party or organization.

The Commission should act to encourage the development of alternatives to the Big Four's expanded domination by explicitly permitting a separation of the financial audit from the 404 audit. My explanation follows.

The GAO authored a June 2003 report on Public Accounting Firms – Mandated Study on Consolidation and Competition. In it the GAO noted that the Big Four “dominated” the international market for audit services and covered 99 percent of public company annual sales. By any measure, this is an oligopoly.

The 404 mandate extended the market of this oligopoly to cover audits of internal controls, linked to the existing financial audit engagements. Other public comments address the cost/benefit of 404 generally but in all fairness, a substantial portion of the frustration with expenses must be traced to the lack of choice in the 404 audit market. The Commission must acknowledge that public firms are legally required to purchase these defined audit services, have a limited choice and are concerned about investor negative reaction should they switch audit firms.

Financial audits generally place limited reliance on internal controls. My experience is that auditors do not reduce their substantive testing regardless of the quality of controls. The most recent compliance deadlines provide another example: the financial audit is essentially complete well before the 404 audit gets signed off.

As a consumer of audit services and a believer in the value of free, open and competitive markets, I believe oligopolies are not helpful and create an indirect tax on investors.

The Commission should act to encourage the development of alternatives to the Big Four's expanded “domination” by explicitly permitting a separation of the financial audit from the 404 audit. It is common and acceptable for tax compliance services to be provided independently and the same should be true for 404 audit services. While the Commission should not require that the financial and 404 audits be performed independently, this option should be available and encouraged for the firm that believes it best for their circumstances.

Sincerely,

Robert O'Callahan