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Chairman Christopher Cox  
U.S. Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549

Acting Chairman Bill Gradison  
Public Company Accounting Oversight Board  
1666 K Street, NW Washington, DC 20006-2803

RE: File Number 4-511  
May 10, 2006 Roundtable on Second-year Experiences with Internal Control  
Reporting and Auditing Provisions

Mr. Chairman and Mr. Acting Chairman:

On behalf of the American Stock Exchange (“Amex,” or the “Exchange”), I would like to express our appreciation for the opportunity to comment on issues related to the implementation of Section 404 of the Sarbanes-Oxley Act of 2002.

Against the backdrop of highly publicized failures of major companies, Congress sought to address public concerns and restore investor confidence in capital markets through the passage of the Sarbanes-Oxley legislation. In the years since the legislation was originally enacted, implementation of the broadly based regulatory initiative has been met with both praise and criticism. In connection with the implementation of Section 404, the Securities and Exchange Commission (“SEC” or the “Commission”) established the Public Company Accounting Oversight Board (“PCAOB”) and created the Advisory Committee on Smaller Public Companies. Similar to the experience with other aspects of the Sarbanes-Oxley legislation, recently released recommendations of the Advisory Committee on Smaller Public Companies were met with praise by some and with criticism from others. The Advisory Committee recommended exempting certain small and mid-cap companies from the full requirements of Section 404. On one side are those who say that such an exemption would potentially leave 80 percent of public companies exempt from Section 404 requirements. On the other side, supporters of the Advisory Committee recommendations point out that the companies affected are relatively small – comprising only about 6 percent of total market capitalization, thus 94 percent of the equity market

capitalization would be fully subject to Section 404 requirements.<sup>1</sup> With so much at stake, we believe that it is worthwhile to examine the possibility of a compromise that aims to address concerns on both sides.

**The Amex has substantial experience with smaller public companies**

As the only national stock exchange whose business model is to provide a welcoming environment for small and mid-sized companies, we feel uniquely qualified to voice concerns on the effects of Sarbanes-Oxley (SOX) on this particular area of the capital market community.

While some of our 600 listed companies are large-cap companies, the majority has small and mid-capitalization between \$50 million and \$500 million. Any regulatory system that discourages such companies from participating in the public markets is of vital importance to our Exchange and our listed companies.

Sarbanes-Oxley and the rules associated with it were established in 2002 to improve corporate governance and internal controls after a wave of accounting scandals that left a black eye on corporate America. These new regulations, however, made no distinction between a billion-dollar large-cap company and a \$75 million small-cap company. The law's failure to recognize the differences makes it extremely difficult for smaller companies to compete and grow in this current regulatory environment.

**Ownership and investor interest is different for small companies**

Investors need to be protected from the corporate scandals that became the impetus for Sarbanes-Oxley, but context is important. The large scandals that led to passage of Sarbanes-Oxley involved large companies or, like Enron, companies that pretended to be large companies. Large-scale investor concerns that were implicated in the Enron scandal typically are not pervasive in the case of small and micro-cap stocks, which, from looking at a sample of Amex-listed companies, frequently have substantial ownership in common between the entrepreneurs and their families who founded the company and public shareholders. The owners are not out to cheat themselves.

Regulators have yet to determine how best to address these corporate governance issues without disadvantaging smaller companies that lack the same resources as larger companies. The key problem that confronts the smaller company is SOX Section 404, which requires designing, documentation and auditing of financial controls.

The SEC has taken steps to address these issues by creating an advisory committee to examine the impact of Sarbanes-Oxley and other aspects of the federal securities laws on smaller companies. Last month, the Advisory Committee on Smaller Public Companies transmitted their recommendations, developed over the previous year with significant public input. As one of those invited to participate in one of several public hearings conducted by the Advisory Committee, the Exchange reached out to numerous Amex-listed companies - who represent the living concerns of this advisory committee - about

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<sup>1</sup> Final Report of the Advisory Committee on Smaller Public Companies to the Securities and Exchange Commission, April 23, 2006, page 7. <http://www.sec.gov/info/smallbus/acspc/acspc-finalreport.pdf>

their thoughts and recommendations on the “one size fits all” approach of SOX Section 404.

The Amex sought input from our market participants, and we received detailed and passionate feedback from the heads of listed companies that were not complaints about the SEC but thoughtful insights on how to implement securities regulations to accommodate the issues and challenges of smaller companies. The point that the chief executives of our listed companies wanted the SEC and the PCAOB to understand and acknowledge is that when it comes to regulating corporate governance, different standards need to apply to companies with small market capitalization or minimal revenues.

The most common concerns that our CEOs voiced on Section 404 related to: 1) duplicative or prohibitive costs, 2) the adverse impact on a company’s relationship with its auditors, and 3) the requirement of segregation of duties within a small company.

Regarding costs to be compliant with Section 404, some of our companies told us that their auditing fees have tripled or quadrupled since the regulation was imposed. A \$500,000 auditing bill may be a drop in the bucket for a company with a \$10 billion market capitalization, but for a \$100 million dollar company, that is a significant amount of money.

**Smaller companies consider overseas exchanges – Loss of business and regulatory oversight**

Uncertainty over the extent to which Section 404 requirement will be applied has led to some smaller companies’ consideration of utilizing non-U.S. capital markets. A May 8 article in Forbes magazine describes how concerns on Section 404 have led smaller companies to look outside the U.S. for capital.<sup>2</sup> The article discusses recent decisions by smaller companies to eschew U.S. capital markets in favor of listing on foreign-based exchanges. In describing efforts by one exchange, the following passage is telling:

Other foreign markets have made gains, too, but London’s AIM has been particularly persistent. In recent months AIM executives have hosted more than 30 pitchfests (sic) in the U.S., wooing investors in New York, Boston, Silicon Valley, Atlanta, Denver and Minneapolis. “It’s not particularly subtle,” says Graham Dallas, a senior international development manager at the London Stock Exchange. “We tell them there is an opportunity-rich landscape for them to exploit. The rules are quite simple and short. Otherwise, companies will spend all their time on compliance and not enough time building wealth.” (IBID)

The Financial Times in an opinion piece dated March 27, 2006 lauded London’s mix of “measured regulation” and “pro-competition orientation” as the engine for the growth of London’s role as a financial center. Sarbanes Oxley was labeled in this piece simply one of “others’ mistakes.”

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<sup>2</sup> “London Calling; Small companies skip the U.S., go public overseas,” *Forbes*, Volume 177 Issue 10, May 8, 2006. <http://www.forbes.com/forbes/2006/0508/051.html>

In a recent trip to Tel Aviv, which is a hot bed of entrepreneurship, particularly in health science and technology, the AIM marketplace is aggressively marketing its lesser requirements, and lower costs, of governance contrasted with the United States. However, in exploring in some depth the specific concerns that many of these companies have, I discovered that most take pride in their internal controls, and the integrity of financial reporting, so were not scared by the concepts. On the other hand, the lack of specific, clearly defined standards does frighten potential entrants to the U.S. markets, as does the annual cost of certification. I believe that some relatively small tweaking of Sarbanes-Oxley rules, as well as clearly defined standards that provide guidance and safe harbors can go a long way to improving the problems with the statute.

Obviously, U.S. exchanges that cater to smaller companies seeking capital by going public should be concerned. However, those with a desire for a stronger regulatory approach should be concerned as well, for with the movement to non-U.S. exchanges, regulatory oversight is lost as well. The Amex believes in a having a strong regulatory environment, although one that allows competition to thrive. Further, the Amex believes that this position is consistent with the '34 Act.

***The Advisory Committee recommendations – is there a compromise position?***

Most industry experts agree that the legislation's intent is laudable, in that it punishes fraudulent behavior and demands executive accountability. However, regulators must take care to avoid the pitfall of imposing a uniform doctrine on small and mid-sized companies that are in the formative stages of their growth. Development stage companies with little or no revenue generally have less complicated financial statements (e.g., because they do not have revenue recognition issues) requiring less rigid internal controls.

The Advisory Committee on Smaller Public Companies report (op. cit.) recommends that the SEC give full Section 404 exemptive relief to some microcap and smallcap companies that comply with enhanced corporate governance provisions. The proposed exemption would apply to:

- microcap companies--companies with equity capitalizations below approximately \$128 million--that have less than \$125 million in annual revenue; and
- small cap companies--companies with equity capitalizations between approximately \$128 million and \$787 million--that have less than \$10 million in annual product revenue.

The committee also recommended that SEC should grant exemptive relief from external auditor involvement in the Section 404 process to smallcap companies with less than \$250 million but more than \$10 million in annual revenues, and microcap companies with between \$125 and \$250 million in annual revenues, subject to their compliance with the same corporate governance standards as the microcap firms.

The Advisory Committee report generated comments, both critical and supportive. Among other objections to the committee proposal for exemption from certain requirements of Sarbanes-Oxley Section 404 for smaller companies, was that 80 percent

of public companies would be exempted in some way from compliance.<sup>3</sup> Supporters of the Committee's recommendations noted, however, that under the recommendations, 94 percent of the U.S. equity market capitalization would be fully covered by Section 404 requirements.

***Is there a "middle ground?"***

We support the conclusions of the Advisory Committee, and believe they represent a sound balancing of interests between regulation and economic growth. In its current form, Sarbanes Oxley reminds one of calls to increase the minimum wage to \$15 an hour: laudable, ethical, but a recipe to move jobs to less laudable jurisdictions. One Israeli woman had it precisely right when she opined that "Sarbanes Oxley is **too** good!"

We also believe that something must be done even if the full range of the Advisory Committee's opinions are not followed. In an effort to obtain the bare bones of some relief, given the polarization of views about large-scale exemptions, I believe that compromise might benefit the process.

One possible approach is that companies with \$200 million in market capitalization and below should be allowed to choose non-compliance with Section 404, but that such a decision must be publicly disclosed, along with a statement as to why the company has chosen not to comply and whether (and if so to what extent) it has taken alternative voluntary steps to monitor its internal controls. Above that level, Section 404 compliance must be certified and then recertified every two to three years, not annually, based on capital. For example, compliance might need to be certified every two years for those companies with a market capitalization above \$500 million but below \$1 billion, and every three years for companies below \$500 million, but above \$200 million. Full compliance would be expected for those companies over \$1 billion in capitalization. This approach gives flexibility to smaller companies, allows for investors to be informed, and provides for a path of growth that ultimately leads to full compliance with Section 404 requirements.

I believe that failure to distinguish the fundamental structural and financial differences between small companies seeking access to U.S. capital markets and larger well financed and capitalized companies in the application of Section 404 requirements would be a mistake that could be detrimental to small businesses in particular and to the U.S. economy in general. Further, the PCAOB must be directed to apply clear, consistent guidelines and definitions to what it expects in the way of 404 compliance. Not all business are run by CPAs or corporate attorneys. Applying Section 404 in a "one size fits all" manner without regard for the disproportionate cost and regulatory burden on smaller companies could well lead those companies to move to overseas capital markets, resulting in both a loss of business for U.S capital markets, and, perhaps just as important, loss of any regulatory oversight that might otherwise be in place.

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<sup>3</sup> Letter from Damon Silvers, Associate General Counsel, AFL-CIO to Christopher Cox and William Gradison. Mar. 27, 2006, <http://www.sec.gov/rules/other/265-23/aflcio032706.pdf>

We also believe that careful examination of the issues faced by smaller companies in complying with Section 404 as outlined in the recommendations of the Advisory Committee on Smaller Public Companies (op. cit.), could lead to a compromise that would not unduly burden small business, yet would provide investors with confidence. We urge the PCAOB to consider a modified, targeted approach towards smaller businesses in the implementation of Section 404.

Sincerely,

A handwritten signature in black ink, appearing to read "Neal Wolkoff". The signature is fluid and cursive, with a large, stylized initial "N" and "W".

Neal L. Wolkoff  
Chairman and Chief Executive Officer