



April 28, 2006

Ms. Nancy M. Morris
Federal Advisory Committee Management Officer
Securities and Exchange Commission
100 F Street NE
Washington, D.C. 20549-1090

**Re: Exposure Draft of Final Report of Advisory Committee on Smaller Public Companies
File No. 265-23**

Dear Ms. Morris:

WithumSmith+Brown Global Assurance, LLC, a division of WithumSmith+Brown, P.C., is pleased to provide our comments on the exposure draft of the Final Report of Advisory Committee on Smaller Public Companies (the "Advisory Committee"). We strongly believe that the issues studied by the Advisory Committee are significant public policy matters, which have a significant impact on the accountability of all businesses when dealing with the investing public. Smaller public companies are key to the future of the country and drive growth and employment. We support the efforts of the SEC in trying to get to the correct balance between compliance and cost.

We have given serious consideration to the recommendations of the Advisory Committee that spent over a year assessing the current regulatory environment for smaller companies and looking for ways to improve it. There is no doubt that there were significant inefficiencies in the initial implementation of the Sarbanes-Oxley Act of 2002 ("SOX") for Accelerated filers. The Public Companies Accounting Oversight Board ("PCAOB"), which was formed by SOX and is responsible for developing the rules and overseeing the external auditors' adherence to them, stated recently that companies and accounting firms faced enormous challenges in their first year implementing Section 404 of SOX. Among the many challenges cited were strains on availability of resources, a shortage of SOX-experienced staff and limited time to implement Section 404. These challenges were compounded by companies needing to make significant improvements in internal control systems to make up for deferred maintenance.

In addition, the PCAOB stated that the audits were not as efficient as they should be and recommended that the auditors take certain steps to improve efficiency. It is clear that change needs to be made. However, in making changes we must be cautious not to create a bigger problem, which could have unintended consequences. Whether we agree or disagree, SOX has become part of doing business and it is not going away. Cost is a factor that must be considered, but we must look at cost broadly. The savings that may be realized with a watered down SOX could be eclipsed by costly litigation, fraud or diluted investor confidence which could limit investment into this vital sector of American business.

Due to the significance of the issues facing smaller public companies, we will focus our comments on the primary recommendations made by the Advisory Committee in Part III relating to internal controls over financial reporting for smaller public companies as well as make comments on the Advisory Committee's reasoning and logic for making the recommendations. We have also weighed the short-term costs against the long-term potential consequences of the recommendations. We would be pleased to answer any questions you may have about our comments. We would welcome participation in the standard setting process. Please contact Tom Basilo, Chairman + CEO of WithumSmith+Brown Global Assurance at (609) 734-9090 x 211 (office), (201) 913-9920 (cell) or via electronic mail at tbasilo@withum.com.



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PART III - INTERNAL CONTROL OVER FINANCIAL REPORTING

The Advisory Committee recommended that the Commission and other bodies, as applicable, effectuate the following:

Recommendation III.P.1:	Recommendation III.P.2:
<p>Unless and until a framework for assessing internal control over financial reporting for such companies is developed that recognizes their characteristics and needs, provide exemptive relief from Section 404 requirements to microcap companies with less than \$125 million in annual revenue, and to smallcap companies with less than \$10 million in annual product revenue,⁹⁹ that have or add corporate governance controls that include:</p> <ul style="list-style-type: none"> ● adherence to standards relating to audit committees in conformity with Rule 10A-3 under the Exchange Act; and ● adoption of a code of ethics within the meaning of Item 406 of Regulation S-K applicable to all directors, officers and employees and disclosure of the code in connection of the company's obligations under Item 406I relating to the disclosure of codes of ethics. <p>In addition, as part of this recommendation, we recommend that the Commission confirm, and if necessary clarify, the application to all microcap companies, and indeed to all smallcap companies also, of the existing general legal requirements regarding internal controls, including the requirement that companies maintain a system of effective internal control over financial reporting, disclose modifications to internal control over financial reporting and their material consequences, apply CEO and CFO certifications to such disclosures and have their management report on any known material weaknesses.</p>	<p>Unless and until a framework for assessing internal control over financial reporting for such companies is developed that recognizes their characteristics and needs, provide exemptive relief from external auditor involvement in the Section 404 process to the following companies, subject to their compliance with the same corporate governance standards as detailed in the recommendation above:¹⁰⁷</p> <ul style="list-style-type: none"> • Smallcap companies with less than \$250 million in annual revenues but more than \$10 million in annual product revenue; and • Microcap companies with between \$125 and \$250 million in annual revenue.¹⁰⁸



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WithumSmith+Brown Global Assurance does not support wholesale exemptions from Section 404 of the Sarbanes-Oxley Act of 2002 (“SOX”) for either microcap or smallcap or permanent exemption from the external audit requirements of Section 404 for smaller public companies. We also do not support **any further delay** in compliance by these companies as they have already been granted three extensions to comply, with the latest granting exemptions until July 15, 2007. In our opinion, continued deferment is ill-advised and contrary to the SEC’s and PCAOB’s statements at the time that the exemption should not be a reason to slow down compliance since smaller public companies will need as much time as possible to comply.

Although we are sympathetic with the pressures on cost experienced by the smaller public companies in significantly greater proportion to their revenues than large corporations, we are unable to overcome the fact that there just are not different standards for internal controls for smaller and large companies. Recommendations that **another** task force be created to further study the issue are misguided. The Committee of Sponsoring Organizations of the Treadway Commission (“COSO”), the group that established the guidance on an integrated framework for internal control in 1992, attempted to provide such guidance in their report entitled, “*Guidance for Smaller Public Companies Reporting on Internal Control over Financial Reporting*,” and the general consensus (outlined in the Advisory Committee’s report) was that it failed to meet the needs of the smaller public companies and most doubted that significant cost savings could be achieved.

Why? Because COSO emphasized that there are not different standards for controls for smaller and larger companies and that smaller companies must adhere to the principles outlined in the original COSO document. This makes sense since the public would not be able to understand that different standards exist. If COSO, which created the standard for internal control compliance, cannot accomplish the assignment, what makes anyone think that a new independent task force can do it? Creating a task force and delaying compliance will just waste time and money, delay implementation of controls and prove to be a disservice to the investing public.

In reaching their conclusions and recommendations, the Advisory Committee argued that the benefits of documenting, testing and certifying the adequacy of internal controls are of less certain value for smaller public companies, because they rely to a greater degree on the “tone at the top” and high-level monitoring controls, which are often not documented and or tested, to facilitate accurate financial reporting. This may be true, but such an environment creates a higher risk of fraud and needs to be documented or tested. In addressing how to resolve the issue of lack of segregation of duties and management override of controls, COSO recommended that a representative of the Board of Directors with financial expertise be charged with the responsibility of overseeing the control environment of smaller public companies. The institution of an internal audit function (in-house or outsourced) that reports directly to the audit committee can be a mitigating control. If the smaller public companies can create effective mitigating controls, they can be documented, tested and relied upon and can be part of an integrated audit approach.



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The use of Management's 302 and 906 certifications (requiring that the CEO and CFO certify that an effective system of internal control is in place) currently is an existing requirement. The SEC's delay in requiring non-accelerated filers (those public companies with a market capitalization of less than \$75 million) to comply with SOX did not remove the Section 302 and 906 certifications. Therefore, CEO's and CFO's of smaller public companies are certifying that these controls exist and are effective while stating that the cost to make them effective is too high. If the CEO and CFO are certifying to this, they must already have internal control documentation in order to feel comfortable enough to sign the certifications.

In our experience, this may not be the case. In fact, using the statistics generated by the proxy research firm of Glass, Lewis & Co. as of May 2005, among the 366 companies that received a qualified opinion, **94 percent** had previously certified their controls as effective as recently as the quarterly finding previous to the SOX 404 report. This result is with the larger public companies that supposedly had the resources to assess their internal controls. Obviously, the threat of criminal penalties has not deterred companies from erroneously reporting on controls. This makes it clearly evident that the Advisory Committee's recommendation for self assessment by smaller companies is flawed. ***Self regulation will not work!***

Another argument that the Advisory Committee makes is that the SEC's estimate of how much adopting the internal control rules would cost (\$91,000) was significantly lower than the actual cost. We have no idea where the cost estimates came from, so it is difficult to argue. No one knew how much work had to be done since standards were not in place. SOX created the Public Company Accounting Oversight Board ("PCAOB") and the PCAOB created the standards.

It should not be forgotten that the fundamental purpose of SOX was to regulate the auditors who, at the time, were its most vocal opponents. SOX was passed overwhelmingly after the WorldCom scandal broke. Investor confidence was low and action needed to be taken to protect the capital markets from collapsing. No one cared, at the time, what it would cost to implement the standards. The cost of inaction was too high! There are many factors that increased the cost of compliance and the companies themselves must share some of the blame for their lack of investment over time in systems infrastructure and design. The Advisory Committee also puts the blame for high costs on the liability environment. Certainly this is true and will continue to be true until tort reform is implemented in this country.

The Advisory Committee also argues that there are fundamental differences between smaller and larger companies. This is certainly true, but when faced with the question as to whether there should be two different accounting standards under generally accepted accounting principles ("GAAP"), the Advisory Committee on Smaller Public Companies to the Financial Accounting Standards Board ("FASB") voted no. They said that the public would be confused and most of the smaller companies would opt for the more stringent standards to show they were not "small." This is inconsistent with the arguments the Advisory Committee makes, which I addressed previously.



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Some facts about smaller public companies:

- Although smaller public companies represent only 6% of the capital markets (but 80% of the number of companies), investment in them is critical to the U.S. economy. If smaller company investors lose confidence in these companies because their expectation that they have good internal controls is not met, our economy will suffer.
- There is a higher incidence of fraud in smaller public companies than in larger public companies.
- There have been more restatements by smaller public companies than larger ones.

The recommendations of the Advisory Committee would greatly lessen the impact of SOX (as only 20% of the registrants would be required to comply) and be a giant step backwards in improving corporate governance, integrity and investor confidence. It would exempt the largest violators from compliance. Cost is a consideration but should not be the primary factor in determining the fate of SOX. Fraud has a much broader impact on a company than simply the loss of tangible assets. We witnessed this in the collapses of Enron and WorldCom, which destroyed Arthur Andersen, small investors, retirees and the independence of AT&T. The root causes of the increased cost include the neglect of companies in investing in their infrastructure.

RECOMMENDATIONS

We believe a more effective approach to the problems being faced by smaller public companies would be the following:

1. All public companies should be compliant with Section 404 of SOX for fiscal years beginning on or after July 15, 2007 and **no more exemptions should be granted.**
2. Instead of permanent exemption from the external auditor attestation requirement, microcap and smallcap companies could be provided relief by mandating such external auditor attestations once every **three years** as long as they receive a clean opinion. An annual external auditor attestation will be required so long as an opinion qualification is present.
3. Instead of an exemption until a new standard can be implemented, smaller public companies could be provided relief by mandating such attestation once **every two years** as long as a clean opinion is received. An annual external auditor attestation will be required, however, so long as an opinion qualification is present.



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4. Allow the market to mature. Several factors are starting to emerge in the marketplace that will drive down the costs of compliance:
 - a. More Firms are in the SOX space, thus creating greater competition for services and driving down prices;
 - b. Regional and middle market firms are gaining more audit clients as the Super Regional and Big 4 firms abandon the middle market space, thus reducing costs;
 - c. Lessons learned from first-year compliance are being implemented, thus reducing time and costs;
 - d. More sophisticated software is available at a cheaper price to reduce time and costs;
 - e. Widespread use of an integrated audit approach may eventually eliminate the need for a separate auditor attestation of internal control;
 - f. The sheer volume of registrants will force the accounting firms to rely more heavily on the work of the internal auditors or S404 consultants, thus reducing total costs of compliance.

Recommendation III.P.3:

While we believe that the current costs of the requirement for an external audit of the effectiveness of internal control over financial reporting are disproportionate to the benefits, and have therefore adopted Recommendation III.P.2 above, we also believe that if the Commission reaches a public policy conclusion that an audit is required, we recommend that changes be made to the requirements for implementing Section 404's external auditor requirement to a cost-effective standard, which we call "ASX," providing for an external audit of the design and implementation of internal controls.

WithumSmith+Brown Global Assurance does not support this recommendation. The most important argument as to why this recommendation will not succeed is that the investing public will be confused. An opinion on the design and implementation of internal control does not address how effective it is in identifying errors or fraud. We are not certain that the investing public will understand the significant difference between the current SOX opinion and the design and implementation opinion. Further, as the Advisory Committee has pointed out, management override of controls can fully negate the design and implementation of the control. In the end, the effectiveness of the internal control environment would be left to self-assessment, which we already stated does not work.



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SOX has been the most significant securities legislation in 70 years. Time is needed to assess the full impact of SOX on the economy and the investment community. It does not make sense to make wholesale changes to the legislation before it is fully implemented by all companies. The first-year of implementation of any new standard is normally the most expensive. The benefits of SOX also must be factored into the equation, including greater investor confidence and more streamlined systems. According to studies, companies that are SOX compliant are realizing a higher multiple in mergers than those that are not compliant.

In summary, we believe that Section 404 needs to be applied consistently to all public companies. We do not object to continued refinement of the implementation process to develop a more cost-effective model, but we do **vigorously** object to any additional delay to compliance by the smaller public companies. We believe that our recommendations present a practical, cost effective alternative to deferment and exemption and still achieve the intended benefits of SOX. We also believe that the marketplace will continue to drive down costs.

Very truly yours,

A handwritten signature in cursive script that reads "Thomas A. Basilo".

Thomas A. Basilo for
WithumSmith+Brown Global Assurance, LLC