

American Federation of Labor and Congress of Industrial Organizations



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February 20, 2006

Via electronic mail

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

Mr. William Gradison, Acting Chairman
Public Company Accounting Oversight Board
1666 K Street, NW
Washington, DC 20006

Dear Chairman Cox and Acting Chairman Gradison:

On February 21, the Small Business Advisory Committee ("Committee") established by the Securities and Exchange Commission ("SEC") is expected to meet and formally present recommendations that if acted upon would seriously undermine the Sarbanes-Oxley Act of 2002. The Small Business Advisory Committee has said it will recommend unlawfully exempting public companies from the internal controls provisions of Sarbanes-Oxley and unlawfully weakening the definition of an audit of internal controls for others. These recommendations are at odds with the general approach to SOX enforcement that the Securities and Exchange Commission and the Public Company Accounting Oversight Board have taken under your leadership and that of your predecessors. The AFL-CIO urges the Commission and the PCAOB to ignore the Committee's specific recommendations and instead to continue to work with auditors and issuers to rationally manage the process of complying with the Sarbanes-Oxley Act.

The AFL-CIO strongly opposes weakening Sarbanes-Oxley's crucial safeguards for the companies most likely to have internal control problems and be engaged in

defrauding investors.¹ Union members participate in benefit plans with over \$5 trillion in assets. Union-sponsored pension plans hold approximately \$400 billion in assets. Workers' pension funds are broadly invested in a variety of small-cap index funds and are sizable shareholders in many small public companies. Most importantly for this issue union members participate in the capital markets as individual shareholders and like other investors are frequently asked by brokers to consider investing in small or micro cap companies. We believe it is irresponsible to allow companies without effective internal controls to sell securities to our members and the investing public.

The Committee's recommendations would exempt a large percentage, perhaps as high as 80% of all public companies, from having to provide investors with transparency with respect to the effectiveness of their internal controls. Companies with a market cap of less than \$100 million and revenue of no more than \$125 million would be exempt completely from 404 requirements. Slightly larger companies, with a market cap of less than \$700 million and revenues of no more than \$250 million, would not be required to undergo a genuine audit in which an independent, outside auditor tests their internal controls.

The Small Business Advisory Committee's recommendations are particularly irresponsible because the Sarbanes-Oxley Act explicitly requires all public companies to attest to the adequacy of their internal controls and to obtain an outside audit of their attestation. The Sarbanes-Oxley Act provides an explicit exemption for investment companies and no further exemptions. Consequently, neither the Commission nor the PCAOB have the authority to either exempt public companies from complying with these internal controls provisions or from obtaining a genuine audit of their attestation. This issue we understand is addressed in the dissent from the recommendations by Kurt Schacht, the sole investor representative on the Committee.

We urge the Commission and the Board to preserve Sarbanes-Oxley and its ability to protect small public company investors. Any exemption, whether in whole or in part, from the internal controls provisions of the Sarbanes-Oxley Act would send the wrong signal to investors and weaken the benefits of stronger controls for the companies most in need of them.

¹ According to former SEC Chairman Arthur Levitt ("A Misguided Exemption," 1/27/2006, *Wall Street Journal*), "[i]n the five years before 2004, nearly three-quarters of financial restatements were reported by companies with annual revenues of less than \$500 million." Kennesaw State University Accounting Professor Dana Hermanson has found that "the typical fraud company was quite small and exhibited signs of an inadequate board and audit committee." He also "often found evidence of management override of internal controls, as the vast majority of frauds apparently went to the top of the organization."

Christopher Cox and William Gradison
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We appreciate the opportunity to present our views on this important matter. If we can be of further assistance please do not hesitate to contact me at 202-637-3953.

Sincerely,

A handwritten signature in black ink, appearing to read "Damon Silvers", with a long horizontal flourish extending to the right.

Damon Silvers
Associate General Counsel
