

# McGladrey & Pullen

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April 3, 2006

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

**Re: Release Nos. 33-8666; 34-53385; File No. 265-23 Exposure Draft of Final Report of Advisory Committee on Smaller Public Companies**

Members and Staff of the Commission:

McGladrey & Pullen, LLP is pleased to submit written comments on the exposure draft of the final report of the Advisory Committee on Smaller Public Companies. McGladrey & Pullen, LLP is a registered public accounting firm that primarily serves private companies and smaller public companies.

**General Comments**

We support the efforts of the Commission and the Advisory Committee to seek improvement in the current regulatory system under the securities laws for smaller public companies. Smaller public companies face unique challenges as they attempt to access the securities markets under the current regulatory system, which is largely a one-size-fits-all system.

**Recommendation II.P 1**

We strongly support this recommendation.

**Recommendation III.P.1-3**

Recommendation III.P.1 advocates the indefinite exemption of microcap companies with less than \$125 million in annual revenue and smallcap companies with less than \$10 million in annual revenue from the Section 404 requirements, unless and until an effective alternative framework for assessing the effectiveness of internal control in smaller issuers is developed. We are also aware that others have advocated an additional optional one-year deferral of the effective date of Section 404 for non-accelerated filers, combined with additional efforts to develop and field test COSO guidance and tools specifically tailored to smaller issuers. We believe that it will be extremely difficult to develop either the appropriate guidance and tools or a revised framework for assessing internal control over financial reporting for smaller issuers that will allow for cost beneficial (efficient and effective) management assessment and auditor attestation. Accordingly, we do not support the additional deferral of the effective date of Section 404 for smaller issuers.

Recommendation III.P.2 advocates the indefinite exemption of microcap and smallcap companies with less than \$250 million in annual revenue from the auditor's attestation required under Section 404(b). Recommendation III.P.3 advocates, in the event that Recommendations III.P.1 and 2 are not adopted, that the auditor attestation requirement under Section 404(b) be modified to permit an attestation on only the design and implementation of internal control over financial reporting. We are concerned that investors would place unwarranted reliance on management's assessment, whether presented without auditor attestation or together with an auditor attestation on design and implementation. Since there are currently no uniform standards governing management's assessment process, we cannot support those recommendations at the present time.

Consistent with Recommendation II.P.1, we recommend that the Commission redefine a small business issuer based on appropriate market capitalization and other metrics (e.g., assets or revenue) for application of Regulation S-B and provide permanent exemptive relief from Section 404 of the Sarbanes-Oxley Act to all such small business issuers. We believe that investors would then be easily able to differentiate between those issuers for which the additional assurance afforded by Section 404 applies and those for which it does not. We also believe that the "risk assessment suite" of auditing standards recently approved by the Auditing Standards Board, in combination with the proposed revisions to the internal control communication requirements referred to in the report will provide increased assurance to investors that internal controls are tested as necessary to support the auditor's opinion on the financial statements and that identified deficiencies in internal control are appropriately classified and communicated to management and the audit committee.

In light of the improvement in financial statement auditing standards referred to above, we also believe it would be appropriate to consider whether the Section 404 requirements for smallcap companies that do not qualify as "small business issuers" could be scaled back to address only internal control over the interim and year-end financial reporting processes, relying on the financial statement audit procedures to provide assurance on the initiation, authorization, recording and processing of transactions. We offer this suggestion because we believe the most significant financial reporting challenge faced by smaller issuers is the proper application of complex accounting standards rather than the proper initiation, authorization, recording and processing of transactions.

### **Recommendations III.S.1 and III.S.2**

We support these recommendations.

### **Recommendations in Part IV of the report**

We support these recommendations except that, consistent with our recommendation set forth above, we believe that recommendation IV.P.2 should apply only to those issuers who meet the revised definition of a small business issuer under Recommendation II.P.1.

### **Recommendations in Part V of the report**

We support these recommendations.

### **Closing Comments**

Thank you for the opportunity to comment on these recommendations. Questions concerning our comments should be directed to Bill Travis, Managing Partner (952.921.7780) or Bruce Webb, National Director of Auditing (515.281.9240).

Very truly yours,

*McGladrey & Pullen, LLP*