



*small public company task force*

March 30, 2006

Nancy M. Morris  
Federal Advisory Committee Management Officer  
U.S. Securities and Exchange Commission  
100 F St. N.E.  
Washington, D.C. 20549-1090  
File No. 256-23 \

Sent via email to: [rule-comments@sec.gov](mailto:rule-comments@sec.gov)

Dear Ms. Morris,

Financial Executives International's ("FEI's") Smaller Public Company Task Force ("SPCTF") is pleased to respond to the Securities and Exchange Commission's (SEC's) Request for Comment on the Exposure Draft (ED) of the SEC Advisory Committee on Smaller Public Companies (the "SEC ACSPC") released on February 28, 2006 (Release No. 33-8666).

FEI is a leading international organization of 15,000 members, including Chief Financial Officers, Controllers, Treasurers, Tax Executives and other senior financial executives. SPCTF is an FEI task force that was created to address the recommendations of the SEC ACSPC. The task force represents the views of smaller public companies. This document reflects the views of FEI's SPCTF, and not necessarily the views of FEI or its individual members.

SPCTF recognizes the significant level of time and effort the SEC ACSPC expended over the past year. The in-depth research gathered at the numerous public hearings is reflected in the recommendations and background provided in the ED. We commend the SEC for supporting this effort. SPCTF comments on specific recommendations are detailed below.

## **I. REPORTING ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

SPCTF recognizes the SEC ACSPC recommended full exemption for microcaps and partial exemption for small cap companies (pertaining to the auditors's report) from Section 404 and the majority of its members support such exemptions. SPCTF believes that the concerns raised to date with respect to the cost-benefit equation of Section 404, particularly as implemented under existing SEC and PCAOB rules, are particularly exacerbated for smaller companies.

We note that Recommendation III. P. 1 of the ED also recommends that "management should be required to report on any known material weaknesses" and the ED states that "the Proposed Statement on Auditing Standards of the AICPA, "Communications of Internal Control Related Matters Noted in an Audit," if adopted by the AICPA and the PCAOB, would strengthen this disclosure requirement and provide some external auditor involvement in the internal control over financial reporting process."

We believe further study is necessary to determine if the above proposed standards of the AICPA would be appropriate or necessary in light of existing SEC standards for disclosure by public companies. We believe further study is needed from the preparers' and investors' point of view.

FEI's SPCTF agree with the recommendation in the ED that further guidance is needed to address the core issue identified by the SEC ACSPC: to improve the cost-benefit equation of complying with Section 404.

Such guidance should come in the form of "right-sizing" AS2 in a separate standard directed at smaller companies in particular, or through "right-sizing" AS2 to address the needs of small and large companies. The "right-sized" standard can reflect learnings of the SEC ACSPC as well as information provided at the upcoming May 10, 2006 SEC-PCAOB roundtable.

In addition, consideration should be given as to whether the SEC needs to issue further guidance for management, and smaller public company management in particular. As has been widely noted, the SEC's management reporting rule under Section 404 provided sparse guidance for management, and the auditing standard (AS2) became the de facto guidance. Although the Committee Of Sponsoring Organizations (COSO) is developing guidance for smaller public companies, it is not yet final and it is unclear whether such guidance will be helpful to smaller public companies in its final form.

## **II. MICRO CAPS AND SMALL CAPS SHOULD HAVE THE OPTION TO PROVIDE A DISCLAIMER**

As an alternative to the ED's recommendation for exemptions of smaller public companies, and in addition to our concurring that further guidance is needed, SPCTF believes that smaller public companies should be allowed an option of providing a "disclaimer" (similar to that for the listing requirements for boards of public companies) to state if they are unable to provide a Section 404 management or auditor's report.

Such a disclaimer would have to provide the reasons why the Section 404 report(s) could not be filed, and would have to be certified by the company's Principal Executive Officer (generally, the Chief Executive Officer or CEO) and the company's Principal Financial Officer (generally, the Chief Financial Officer or CFO), in conformity with the signature requirements for the Section 404 reports and Section 302 certifications.

Further consideration would have to be given to SEC filing status and stock exchange listing requirements, for companies that file their 10-Ks without a Section 404 report, and with a disclaimer only.

## **III. MORE GUIDANCE SHOULD BE ISSUED BY THE SEC WITH RESPECT TO MATERIALITY**

SPCTF supports the ED's recommendations that the SEC issue further guidance with respect to materiality, especially the use of quarterly (versus annual) materiality for purposes of accounting recognition and disclosures relating to prior period restatements.

## **IV. DETERMINE THE NECESSARY STRUCTURE FOR COSO**

The ED states this is necessary because COSO has been placed in an "elevated role" by virtue of its reference in the SEC rule on management reporting and in PCAOB's AS2. The ED further recommends that the SEC, "in conjunction with other interested bodies, as appropriate, should determine the necessary structure for COSO, including a broader member constituency, to strengthen it in light of its important role in establishing and providing guidance with respect to the internal control framework used by most companies and auditors to evaluate the effectiveness of internal control over financial reporting."

We do not believe it is appropriate at this time for COSO to become a standard setter. COSO is undergoing its own strategic planning process, and we support that effort.

We do not agree that the status of COSO has been “elevated”. COSO has been the predominant internal control guidance used in the U.S. since 1992. However, COSO is not a standard-setter in the sense of the regulators and standard-setters such as the SEC, PCAOB, and FASB. The strength of COSO has been, by its very nature, as a private sector initiative. If COSO were to be elevated as a standard-setter, it will potentially preclude the direct participation of private sector sponsoring organizations, which includes FEI. One of the complicating factors with respect to Section 404, has been, as widely noted, the lack of specific guidance for management in the SEC rule, the default to PCAOB’s AS2, and the resultant request that COSO issue guidance for management, specifically small company management.

Based on reading COSO’s ED issued in October 2005, comment letters filed in response to the ED, and the other findings in the SEC ACSPC’s report, much of the current approach to Section 404 is, as it should be, derived from and limited by the requirements of the SEC’s and PCAOB rules (standards); thus, the COSO 1992 Framework may not have been at issue, as much as the SEC’s and PCAOB’s rules themselves, which are most properly considered directly by the SEC and PCAOB, not by the COSO guidance.

#### **V. PRINCIPLES-BASED (OBJECTIVES-BASED) ACCOUNTING AND REDUCING COMPLEXITY**

The SEC should formally encourage the FASB to continue pursuing objectives-based accounting standards. Microcap companies should be permitted the same delayed effective date as private companies.

SPCTF supports the ED’s recommendation that the SEC once again formally encourage the FASB to continue to pursue objectives-oriented accounting standards. We also commend the SEC ACSPC for addressing the importance of combating complexity by further specifying in its recommendation, in addition, simplicity and the ease of application should be important considerations when new accounting standards are established. FEI’s SPCTF supports the recommendation that microcap companies should be permitted the same delayed effective date as private companies.

Thank you for considering our views. We would be happy to discuss this further at your convenience or respond to any questions you may have. Please feel free to contact Serena Dávila at sdavila@fei.org, (202) 626-7809 or Rick Brounstein at broun@comcast.net, (510) 774-1969 should you have any questions.

Sincerely,



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Financial Executives International  
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