

September 2, 2005

Mr. Jonathan G. Katz
Committee Management Officer
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-6561

File No.: 265-23
Request for Public Input by Advisory Committee on Smaller Public Companies

Dear Mr. Katz:

The Center for Public Company Audit Firms (the “Center”) of the American Institute of Certified Public Accountants (“AICPA”) is pleased to submit written comments on the Securities and Exchange Commission’s (“SEC” or the “Commission”) Advisory Committee on Smaller Public Companies’ (“Advisory Committee”) request for input on ways to improve the current regulatory system for smaller companies under the securities laws of the United States, including the Sarbanes-Oxley Act of 2002 (“SOX”).

The Center was established by the AICPA to, among other things, provide a focal point of commitment to the quality of public company audits and provide the SEC and the Public Company Accounting Oversight Board (“PCAOB”), when appropriate, with comments on their proposals on behalf of Center members. There are approximately 900 Center member firms that collectively audit 97% of all SEC registrants (and 91% of the non-accelerated filers are audited by Center member firms). All of the Center’s member firms are U.S. domiciled accounting firms. The AICPA is the largest professional association of certified public accountants in the United States, with more than 340,000 members in business, industry, public practice, government and education.

Below are the Center’s responses to certain questions posed by the Advisory Committee in its request for input on ways to improve the current regulatory system for smaller public companies under the securities laws of the United States, including SOX.

General Impact of Sarbanes-Oxley Act

Following is the Center's response to questions 1-9 on the general impact of SOX:

The Center's primary goal is the enhancement of the quality of public company audits. That said, our members strongly believe that SOX has had a positive impact on financial reporting, corporate governance and the quality of public company audits. In general, we believe that the benefits of SOX outweigh the costs for accelerated filers. We understand that some of the beneficial provisions of SOX come with substantive costs such as Section 404 as discussed below. There are also many beneficial provisions of SOX that come with very little associated cost. We encourage the Advisory Committee to carefully and completely consider the cost and benefit of recommendations to the SEC, not only to smaller public companies, but for all stakeholders in the capital market system. Overall, the members of the Center support increased accountability, strengthened corporate governance, and improving audit quality as a means to positively impact the quality of financial reporting.

SOX Section 404/Internal Controls

10. In developing a "risk-based" approach for assessing and auditing internal control over financial reporting for smaller companies under SOX Section 404, what criteria would you use to categorize internal controls from the highest risk to the lowest risk controls?

We believe the control environment at a smaller public company should be treated as a high risk area. Management's effect on governance is generally more pronounced at a smaller public company which increases the potential opportunities for management override of processes to accomplish perceived reporting objectives.

The risk of material misstatement (notwithstanding the threat of fraud due to management override) is adversely affected by the inherent risk of the account and the materiality of the account. Inherent risk will typically increase for more complicated transactions and for those where the accounting is more subjective. Additionally, those amounts that are the most material (qualitatively as well as quantitatively) potentially have the greatest effects for financial statement user if they are wrong. The accounts that have high inherent risk and high materiality should be rated the highest risk. Those of low inherent risk and low materiality should be rated as the lowest risk. However, even lower risk accounts must be included in the scope of the assessment and auditing processes if they are material to the financial statements, individually or in the aggregate.

11. Do you believe that at least some SOX Section 404 internal controls for smaller companies can be appropriately assessed less often than every year? If so, what controls do you think need to be assessed by management every year? What controls do you think need to be assessed at least every two years? What controls do you think could be assessed only once every three years?

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The wording of question 11 is unclear as to whether it refers only to management's assessment or to the related audit of controls by outside auditors as well. With respect to management's assessment, management has some discretion as to which controls are assessed in reaching management's conclusions as to the effectiveness of internal controls over financial reporting.

The extent of the auditor's work is governed by PCAOB Auditing Standard No. 2 *An Audit of Internal Control Over Financial Reporting Conducted in Conjunction with an Audit of Financial Statements* (AS 2). We support AS 2 and its fundamental principle that each year, sufficient evidence about the effectiveness of controls for all relevant assertions related to all significant accounts and disclosures must be obtained. Any change in this principle would require a change to current standards.

12. Current standards require that the auditor must perform enough of the testing himself or herself so that the auditor's own work provides the principal evidence for the auditor's opinion. Are there specific controls for smaller companies for which the auditor should appropriately be permitted to rely on management's testing and documentation? Are there specific controls for smaller companies where this is particularly not the case?

Generally, our members believe that AS 2 permits judgment in determining the extent to which external auditors may use the work of others (e.g., internal auditors) in their evaluation and testing. Additionally, the May 16 guidance from the PCAOB provided additional clarification on this topic. Therefore, we are supportive of AS 2 and the existing guidance that is currently in effect.

13. Is the cost and timing of SOX Section 404 certification a deterrent to smaller companies going public? Are there companies where this deterrent is appropriate? (I.e., are there companies that should not go public and is SOX Section 404 one appropriate control on the process?) If there is such a deterrent, would it be appropriate to provide some exemption or special consideration to companies that have recently gone public, and for how long would you extend this special treatment?

As previously stated, our members are supportive of the positive impact that SOX has had on the capital markets and financial reporting. As discussed in the answer to question 14 below, certain exemptions for certain size companies may be warranted. However, if a company is required to comply with SOX Section 404 then those requirements should be effective as companies enter the capital markets. If the decision to not go public is the result of an inability to comply with SOX Section 404, we believe this is an appropriate deterrent and in the public interest. As a result, we would not be in favor of granting an exemption from Section 404 other than as discussed in the response to question 14.

14. Do the benefits of SOX Section 404 outweigh its costs for smaller companies? Please explain. Would you support a total exemption from SOX Section 404 requirements for smaller companies? Why or why not? Would such an exemption have a negative effect on investors' interests or perception regarding smaller companies? Why or why not?

We support the Advisory Committee's recent recommendation relative to the definition of a smaller public company and therefore, believe that certain regulatory changes may be appropriate. We recommend that if the Advisory Committee and the SEC were to decide that the burden of compliance with SOX Section 404 outweighs the benefits for public companies of a certain size (for example, companies representing 1% of the total U.S. public market capitalization), then such companies could be provided relief in the form of an exemption from the requirement of SOX Section 404, by making compliance voluntary. We support further study and recommend the Advisory Committee and the SEC to continue to solicit the input from all stakeholders in the capital markets, specifically investors, to determine the threshold for such exemption, if deemed appropriate. Depending on the input from investors, the Advisory Committee may choose to condition exemption on shareholder ratification on a company by company basis. Moreover, it would need to be clear to these companies that they still have an obligation to have adequate internal controls and management will still need to annually assess the effectiveness of internal controls over financial reporting.

With respect to COSO, their Internal Control – Integrated Framework (the Framework) has been recognized by regulatory standard setters and others as a comprehensive framework for evaluating public companies' internal control over financial reporting as a result of Section 404. As such, we recommend that consideration be given to having COSO become a more formalized body that has recognized standard setting authority to promulgate changes to the Framework to address environmental changes (e.g., financial reporting, corporate governance, regulatory, etc.) that have already taken place or that could take place in the future.

Accounting/Auditing

15. Has SOX affected the relationship of smaller companies with their auditing firms? If yes, how? Is the change positive or negative?

We believe that the relationships between public companies of all sizes, smaller as well as large public companies, and auditing firms have been affected by SOX. We believe that SOX contemplated changes in these relationships and some of the new tension that exists was intended and healthy. However, there were also in some cases, some unintended consequences and unhealthy strains on relationships.

Early in the process, the relationship between certain auditors and management with respect to seeking accounting advice from the auditor changed as a result of an unintended consequence of AS 2. Management may have been reluctant to discuss or

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communicate about the proper implementation of accounting standards out of concern that such discussions or communications may be perceived to be a weakness in the entity's internal control over financial reporting. And some auditors may have been reluctant to have these conversations because of concerns that such conversations would be perceived as impairing their independence.

To address these concerns and clarify their views, both the PCAOB and the SEC issued guidance on May 16, 2005 which, among other things, encourages auditors and their clients to engage in direct and timely communication to seek auditors' views on accounting or internal control issues before those clients make their own decision on such issues, implement internal control processes under consideration or finalize financial reports. We believe that the May 16 guidance has provided needed clarity in this area and has fostered a more balanced view of these issues in practice.

Following is in the Center's response to questions 16 and 21:

While not an activity of the Center, you may be aware that the AICPA and the Financial Accounting Standards Board are collaborating on an initiative to explore ways to improve the usefulness of GAAP financial reporting for private companies. We suggest that the Advisory Committee recommend that the Commission monitor this initiative to determine whether any information gained from their work may result in knowledge that might also apply to smaller public company financial reporting and thus help address the questions in this area. It is our understanding that their scope is limited to private companies. We are not recommending multiple GAAP models for public companies.

17. For smaller companies, would extended effective dates for new accounting standards ease the burden of implementation and reduce the costs in a desirable way? How would such extensions affect investors or markets? Would allowing a company's independent auditors to provide more implementation assistance than they are able to currently reduce such burdens or costs? Would such a step positively or negatively affect the quality of audits? Please explain.

Some of our members believe that extension of the effective dates for new accounting standards would ease the burden of implementation and serve to reduce costs. Smaller companies do not have the resources to enable them to implement complex or new standards in an effective manner as quickly as larger companies. If additional time is afforded, this would enable smaller companies to implement new standards in a more efficient and effective manner. In addition, learning from the experiences of larger companies that implement in advance of smaller companies is also very helpful. There should also be encouragement to the smaller companies to seek advice and assistance from their auditors as noted and encouraged in the guidance issued by the SEC and PCAOB in May 2005. Of course, auditors must be careful not to go so far that they are calculating financial statement amounts or preparing the financial statements, but certainly the public interest is served through more reliable and

accurate information, arising from early communications and candid discussions between auditors and management.

18. Would auditors providing assistance with accounting and reporting for unusual or infrequent transactions impair the auditors' independence as it relates to smaller companies? Would providing such assistance reduce the cost of compliance for smaller companies? What would be the impact on the quality of audits, investors or markets? Please explain.

If appropriately executed, auditors should be able to provide assistance and advice to audit clients with respect to unusual and infrequent transactions without violating the SEC or PCAOB independence rules, and as clarified in their May 16 guidance. We encourage this type of close communication between auditor and client on issues of this type and believe that investors and users of the financial statements are better served and overall compliance costs will generally be lower, so long as the auditor independence rules are followed.

Disclosure System

27. Will the phase-down to the final accelerated reporting deadlines for periodic reports under the 1934 Act for companies with \$75 million market capitalization (ultimately 60 days for Form 10-K and 35 days for Form 10-Q) be burdensome for smaller companies? If so, please explain the manner and extent of this burden. Does the burden outweigh benefits to investors and markets for smaller companies?

Our members support a permanent delay of the second phase of the Commission's rule regarding Acceleration of Periodic Report Filing Dates ("the Acceleration Rule") for all public companies regardless of the size. Given new regulatory requirements such as the application of SOX Section 404 we believe the implementation of the second phase of the acceleration rule would diminish the quality of disclosures and result in increased and unnecessary costs, while not providing significant corresponding benefit to investors. Accelerating the filing deadline serves to provide more timely information to investors, but it is evident that further accelerating the deadline places pressure on public company management, legal counsel, financial reporting staff, and audit committees, in addition to the time constraints placed on the independent auditor. This pressure is exacerbated at smaller public companies given constraints with resources and personnel. We believe the Commission's current focus on providing quality disclosures demanded by the market and investors is paramount and should not be sacrificed for accelerated timing. As such we do not support any further acceleration of filing requirements for annual and interim financial statements for smaller as well as large public companies.

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The AICPA Center for Public Company Audit Firms appreciates the opportunity to provide the Advisory Committee with input on ways to improve the current regulatory system for smaller public companies under the securities laws of the United States, including SOX. We are firmly committed to working with the SEC and are pleased to discuss these comments with you at your convenience.

Sincerely,

A handwritten signature in black ink, appearing to read "Robert J. Kueppers". The signature is fluid and cursive, with a long horizontal flourish extending to the right.

Robert J. Kueppers
Chair
Center for Public Company Audit Firms

cc: Chairman Christopher Cox
Commissioner Cynthia A Glassman
Commissioner Paul S. Atkins
Commissioner Roel C. Campos
Commissioner Annette L. Nazareth
Alan L. Beller
Donald T. Nicolaisen