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October 31, 2005

Mr. Jonathan G. Katz, Secretary  
Securities and Exchange Commission  
100 F Street, N.E.  
Washington, DC 20549-9303

**File No. S7-06-03**

**Final Rule: Management's Report on Internal Control Over Financial Reporting  
and Certification of Disclosure in Exchange Act Periodic Reports of Companies that  
Are Not Accelerated Filers  
Release Nos. 33-8618; 34-52492**

Dear Mr. Katz:

KPMG LLP appreciates the opportunity to provide comments on matters regarding application of the Securities and Exchange Commission's reporting requirements related to internal control over financial reporting to companies that are not considered accelerated filers. These comments are made in response to questions included in the Commission's final rule, *Management's Report on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports of Companies that Are Not Accelerated Filers* (the Final Rule).

KPMG LLP supports the Committee of Sponsoring Organizations of the Treadway Commission (COSO) project, *Implementing the COSO Control Framework in Smaller Businesses*, intended to develop guidance for applying the existing COSO framework in a small-business environment. We have commenced our review of COSO's exposure draft on this subject and look forward to providing input on matters particularly relevant to internal control over financial reporting in a small-business environment.

KPMG LLP firmly believes that the fundamental tenets of internal control over financial reporting outlined in the existing COSO framework are applicable to companies of all sizes and complexity. However, we do recognize that application of such fundamental tenets



will vary depending upon an entity's size and complexity, and believe that additional guidance directed toward the needs of the small-business community will further the effective implementation of internal control concepts in that environment. In addition, we believe that the provisions of Public Company Accounting Oversight Board Auditing Standard No. 2, *An Audit of Internal Control Over Financial Reporting Performed in Conjunction with An Audit of Financial Statements*, (Standard No. 2) provide sufficient flexibility to enable their effective application in smaller-company environments. As noted in paragraph E60 of Standard No. 2, "The Board considered cautionary views about the difficulty in expressing accommodations for small and medium-sized companies without creating an inappropriate second class of internal control effectiveness and audit assurance." We do not support an alternative auditor-reporting model that provides for the expression of varying levels of assurance depending on the size and/or complexity of the related issuer. We agree with the PCAOB's sentiments evidenced in paragraph E60 of Standard No. 2 and believe that the unavoidable confusion resulting from such an alternative auditor-reporting model runs contrary to the public interest objective of internal control reporting.

We believe that the \$75 million public float threshold established by the Commission to delineate non-accelerated filers establishes a reasonable line of differentiation, and we support the Commission's proposal to amend the definition of an accelerated filer to create a "large accelerated filer" category for companies with \$700 million or more in public float. We also recognize that implementation of the provisions of Section 404 of Sarbanes-Oxley (Section 404) for issuers that marginally meet the \$75 million public float threshold for the first time has, to date, proven to be a significant undertaking requiring extensive front-end planning and coordination. In the interest of alleviating some of the pressure associated with this significant undertaking, we support revising the measurement date for purposes of determining accelerated filer status.

We address this matter in greater detail in our letter to the Commission, dated October 31, 2005, in reference to File No. S7-08-05, Proposed Rule: Revisions to Accelerated Filer Definition and Accelerated Deadlines for Filing Periodic Reports – Release Nos. 33-8617 and 34-52491. In that letter, we propose consideration of the following alternatives to the "point-in-time" measurement of public float as of the end of the second fiscal quarter:

- Measurement of public float based on an average of more than one quarter;
- Measurement of public float based on a date earlier in the issuer's fiscal year; or
- Deferral of compliance with Item 308 of Regulation S-K until the first year after the fiscal year during which the accelerated filer threshold is met.



Providing additional lead-time to issuers and auditors in the small-business community in order to implement the provisions of Section 404 would, we believe, facilitate more effective execution of the related requirements and ultimately serve the public interest.

We believe that the objectives of enhanced financial reporting and increased investor confidence are best achieved by ensuring that all issuers comply with the requirements of Section 404. In the event the Commission was to consider exemptive relief from the requirements of Section 404, we suggest the following alternatives:

- Full exemption from the requirements of Section 404 for certain companies that fall below a predetermined public float threshold. This exemption should run both to management's report pursuant to Section 404(a) and the registered public accounting firm's report pursuant to Section 404(b); or
- Full exemption from the requirements of Section 404 for those companies whose shareholders have approved a plan to not comply with the provisions of Section 404(a) and Section 404(b). This approval should cover a period of reporting periods; say three years, to avoid the possibility of alternating compliance in successive periods.

Under either scenario noted above, we believe it is important that the exemption run both to management's and the auditors' reporting responsibilities.

Our integrated audit methodology facilitates leveraging the audit engagement team's knowledge of an entity's internal control environment in determining the nature, timing and extent of substantive audit procedures to perform. We have revised our integrated audit methodology to reflect lessons learned from the first year of implementation of Standard No. 2 and the May 16, 2005 SEC and PCAOB guidance. Effective integration of the financial statement and internal control audits in a small company environment has a significant bearing on the ultimate cost of compliance with the provisions of Section 404. We are committed to a continuous improvement initiative relative to our integrated audit methodology that will ensure the most appropriate and most effective implementation of the provisions of Standard No. 2.



KPMG LLP appreciates the opportunity to comment on the Final Rule. If you would like to further discuss any of the matters addressed in this letter, please contact Sam Ranzilla at (212) 909-5837; [sranzilla@kpmg.com](mailto:sranzilla@kpmg.com), or Craig Crawford at (212) 909-5536; [ccrawford@kpmg.com](mailto:ccrawford@kpmg.com).

Very truly yours,

*KPMG LLP*