

October 31, 2005

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

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

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) request for input about the application of the internal control reporting requirements under Sarbanes-Oxley Act of 2002 Section 404 (SOX 404).

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 SEC in its request for input about the application of SOX 404 for non-accelerated filers.

***Should there be a different set of internal control over financial reporting requirements that applies to smaller companies than applies to larger companies? Would it be appropriate to apply a different set of substantive requirements to non-accelerated filers, or for management of non-accelerated filers to make a different kind of assessment? Why or why not? If you think that there should be a different set of requirements for companies that are not accelerated filers, what should those requirements be? What would be the impact of any such differences in the requirements on investors?***

Generally, we believe that because smaller public companies have made the decision to obtain capital through the public markets, they also should adhere to the same requirements for internal control over financial reporting. We point to the positive impact that SOX 404 has had on the capital markets and financial reporting. We believe holding smaller public companies to the same requirements for internal control over financial reporting helps protect investors and is in the best interests of the public. In addition, we believe that companies of all sizes should follow the Internal Control – Integrated Framework developed by the Committee of Sponsoring Organizations of the Treadway Commission (COSO Framework), particularly since new guidance with a concentration on smaller public company implications has recently been exposed for public comment.

However, we share the SEC's practical concerns regarding the disproportionate cost of applying SOX 404 in smaller companies. We support further study and recommend that the SEC and the Advisory Committee on Smaller Public Companies (the Advisory Committee) continue to solicit input from all stakeholders in the capital markets, particularly investors, to determine whether and at what threshold to provide an exemption or to make compliance voluntary for public companies of a certain size (for example, the smallest companies representing 1% (or some other percentage) of the total U.S. public market capitalization). If the SEC were to determine that the burden of compliance with SOX 404 outweighs the benefits for the smallest companies, we would support the SEC providing relief to such companies in the form of an exemption from the requirements of SOX 404 or by making SOX 404 compliance voluntary. Depending on the input from investors, the SEC may choose to condition compliance on shareholder ratification on a company by company basis. Moreover, it would need to be clear to the management of these defined companies of a certain size that they still have an obligation to the shareholders to have adequate internal control over financial reporting and that management should still annually assess the effectiveness of internal control over financial reporting regardless of whether formal management or auditor reporting is required.

***Would a public float threshold that is higher or lower than the \$75 million threshold that we use to distinguish accelerated filers from non-accelerated filers be more appropriate for this purpose? If so, what should the threshold be and why? Would it be better to use a test other than public float for this purpose, such as annual revenues, number of segments or number of locations or operations? If so, why?***

In our prior comment letters and in the Center's comment letter on the SEC's Proposed Rule: *Revisions to Accelerated Filer Definition and Accelerated Deadlines for Filing Periodic Reports* (File No.: S7-08-05), we recommend revising the definition of an accelerated filer to increase the public equity float threshold from \$75 million to \$700 million. However current accelerated filers (issuers with over \$75 million public equity float) were required to comply with SOX 404 in fiscal years ending after November 15, 2004. Whether or not issuers with less than \$700 million public equity float remain accelerated filers, we recommend that SOX 404 continue to apply to any issuer that has already adopted SOX 404. It would be counterproductive to roll back the internal control reporting requirements for companies that have already adopted SOX 404, because these companies and their auditors are already fully engaged in this process with the most labor intensive year behind them. In addition, there is a great deal to be learned from year two experiences with regard to cost/benefit of SOX 404, for which data should be accumulated for as many companies as possible. Companies with public equity float between \$75 million and \$700 million are precisely the group of issuers that will provide the most relevant information to assess the costs and benefits of SOX 404 at smaller public companies. However, as articulated in our other comment letter on File No.: S7-08-05, we recommend that the Form 10-K filing deadline for these issuers should return to 90 days, which would provide a critical additional fifteen days to complete their financial and internal control reporting. Additionally, it is in the public interest to continue the internal control reporting for as many companies as possible.

In addition, consistent with our recommendations in our other comment letter on File No.: S7-08-05, we recommend that the SEC consider the current transition rules for first-time accelerated filers in the context of internal control reporting. Under the current rules, when an issuer first crosses the threshold to become an accelerated filer, it is required to accelerate its financial reporting as well as implement the internal control reporting requirements of SOX 404, both for the first time. During the remaining SOX 404 transition period (and if the SEC subsequently adopts any exemptions for smaller public companies), the SEC should give further consideration to whether a non-accelerated (or exempt) filer has sufficient time to prepare to report under SOX 404 for the first time. Given that the calculation of an issuer's public equity float occurs at the end of its second fiscal quarter under the SEC's definition of an accelerated filer, a non-accelerated filer that exceeds the public equity float threshold for the first time would essentially have only six months to prepare for its initial reporting under SOX 404. Based on our experience, this generally would not provide a smaller public company a sufficient amount of time to accelerate the procedures necessary to report under SOX 404. Accordingly, until such time that SOX 404 applies universally to all issuers, we recommend that the SEC modify its existing transition provisions such that a non-accelerated filer (or an issuer otherwise exempt from SOX 404) must first comply with SOX 404 in its second annual report after becoming an accelerated filer (or losing its SOX 404 exemption). Such modification would provide non-accelerated (or exempt) filers with a more reasonable period of time to prepare to report under SOX 404 in an orderly and cost-effective manner.

***Should the independent auditor attestation requirement be different for smaller public companies? If so, how should the requirements differ?***

Consistent with our response to the first question above, generally we believe that there should not be different standards of auditor attestation on internal control over financial reporting for different tiers of public companies. Auditors providing less assurance or reporting less frequently based on the size of a company would likely confuse investors and further widen the expectation gap.

In the May 2005 guidance on SOX 404, the SEC and PCAOB advocated the use of a top-down, risk-based approach. We believe that, given that risk assessment underlies the entire audit process and has a pervasive effect on the amount of work auditors perform in an audit of internal control over financial reporting, there is sufficient flexibility within the framework of PCAOB Standard No. 2, *An Audit of Internal Control Over Financial Reporting Performed in Conjunction with an Audit of Financial Statements*, to allow auditors to scale the nature and extent of testing performed to the size and complexity of the issuer.

We believe that creating different auditor attestation requirements for smaller public companies would be potentially misleading and confusing to the investors, companies and auditors and would add unnecessary complexity to the reporting system. Unless the SEC determines that an exemption from SOX 404 is warranted for certain issuers, smaller public companies and their auditors should be held to the same management assessment and auditor attestation requirements as the larger public companies.

***Should the same standard for auditing internal control over financial reporting apply to auditors of all public companies, or should there be different standards based on the size of the public company whose internal control is being audited? If the latter, how should the standards differ?***

Our response is the same as articulated in response to the previous question.

***How can we best assure that the costs of the internal control over financial reporting requirements imposed on smaller public companies are commensurate with the benefits?***

Generally, we believe that SOX 404 is a good investment for investors as noted from the first wave of companies that have complied, as well as from feedback received at the April 2005 SEC 404 Roundtable and from our members' clients. However, these benefits do not come without costs. We believe that first year implementation costs are easier to quantify and articulate compared to the related, less transparent but potentially very significant benefits. Significant costs are incurred by many companies to gain knowledge and experience when implementing SOX 404 for the first time. However, we believe that if non-accelerated filers start the process of implementation early and take advantage of the extension of time to comply, then diversion of management's attention away from operational activities will be lessened significantly. We believe in careful planning for the

project of reporting under SOX 404. Management should have a good understanding of SOX 404 and the COSO Framework; engage the external auditors and audit committees early; obtain a good understanding of fraud; anticipate early where any potential material weaknesses may be, actively work to remediate any identified internal control deficiencies, potentially providing an immediate benefit to financial reporting; and follow the guidance issued by the SEC and PCAOB on May 16, 2005. The AICPA is committed to communicating with its members to encourage them to get started early on the SOX 404 reporting process so as to minimize any potential opportunity costs.

Time will tell more about the cost/benefit of SOX 404 based on the year two experiences of the accelerated filers that have adopted SOX 404 to date. It is expected that, for a host of reasons, costs for companies in year two of 404 compliance will be significantly less than in year one. The largest cost components are internal costs and external "readiness" cost which should be much lower in year two. At the same time, benefits that were identified but were hard to measure in year one should be more apparent in the second year.

In addition, the new COSO Framework guidance, which has recently been exposed for public comment, may provide more insight as to the implications for smaller public companies' adoption of SOX 404 for purposes of determining the timing of work and thresholds for adoption. We encourage the SEC to continue to look for ways to measure and research the benefits and costs of SOX 404. Until there is more complete research in this area, the true economic benefit of SOX 404 remains unknown and any estimates are only a guess based on partial data.

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The AICPA Center for Public Company Audit Firms appreciates the opportunity to provide the SEC with input about the application of the SOX 404 internal control reporting requirements for smaller public companies. We are firmly committed to working with the SEC and are pleased to discuss these comments with you at your convenience.

Sincerely,



Robert J. Kueppers  
Chair  
Center for Public Company Audit Firms

Securities and Exchange Commission

October 31, 2005

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cc: Chairman Christopher Cox  
Commissioner Cynthia A Glassman  
Commissioner Paul S. Atkins  
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