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October 2, 2006

The Honorable Christopher Cox  
Chairman  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549

Dear Chairman Cox:

I am submitting comments on the Securities and Exchange Commission's (SEC) proposed rulemaking and deadline extension for the internal control requirements of section 404 of the Sarbanes-Oxley Act of 2002.

The Sarbanes-Oxley Act has been a successful tool in restoring investor confidence in the market. While it has considerable benefits, the Act, particularly section 404, also imposes significant costs on public companies. Smaller companies are facing disproportionately higher compliance costs associated with implementing section 404. In moving forward with a rule, SEC should focus on actions that will reduce the burden on small businesses while maintaining the Act's important investor protections.

I commend SEC's willingness to take the step of issuing additional guidance to improve the implementation of section 404. I appreciate SEC's efforts to obtain public comments early in this process as well as the various opportunities SEC has provided for stakeholders to provide input during the first two years of the Act's implementation.

**I. SEC Should Issue Additional Guidance to Management on Section 404**

SEC should issue additional guidance that provides management with specific information about how to assess and test internal controls. In an April 2006 report, the Government Accountability Office (GAO) found that the absence of detailed SEC guidance has resulted in management assessments of internal controls being driven by the Public Company Accounting Oversight Board's (PCAOB) Auditing Standard No. 2.<sup>1</sup> Providing management with guidance on how to assess and test internal controls will be an important step forward in giving management the tools needed to implement section 404.

SEC should issue guidance aimed at helping all public companies comply with section 404 regardless of size. However, additional guidance should address specific challenges faced by small businesses and should incorporate the flexibility needed to allow smaller companies to respond in a manner that is appropriate for the company's size and complexity.

<sup>1</sup> Government Accountability Office, *Sarbanes-Oxley Act: Consideration of Key Principles Needed in Addressing Implementation for Smaller Public Companies* (Apr. 2006) (GAO-06-361).

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The Committee of Sponsoring Organizations of the Treadway Commission (COSO) recently issued guidance on internal control over financial reporting for small businesses. COSO's guidance provides principles aimed at helping small businesses implement section 404. While COSO's new guidance will no doubt provide small businesses with some help in interpreting COSO's existing internal controls framework, there remains a need for substantive instruction for small businesses on how to assess their internal controls. SEC should supplement COSO's principles by providing such guidance.

I was among a group of 45 members of Congress who wrote SEC and PCAOB on June 21, 2006, in part urging SEC to ensure that additional guidance is "user friendly" for small businesses. I hope SEC will continue to keep in mind the need to make additional guidance functional for its intended audience.

## **II. SEC Should Coordinate with PCAOB**

It is essential that SEC coordinate any guidance on management requirements with any action PCAOB takes regarding Auditing Standard No. 2. In its April 2006 report, GAO recommended that SEC coordinate with PCAOB to ensure that additional SEC guidance for management is consistent with PCAOB's section 404-related audit standards and guidance. GAO also recommended that SEC work with PCAOB to identify ways in which auditors can have more "economical, effective, and efficient" implementation of the standards and guidance related to internal controls over financial reporting. I urge you to implement GAO's recommendations.

I am especially concerned with, and urge SEC to work with PCAOB on addressing, the definition of "materiality." I have heard from companies that are experiencing significant compliance burdens because auditors are interpreting materiality so broadly. The definition of materiality should be clarified to ensure that auditors and management take a narrower, risk-based approach.

## **III. SEC Should Provide Adequate Time for Implementation**

As proposed in SEC's August 9th release, you should extend the compliance deadline for smaller public companies.<sup>2</sup> SEC's proposal wisely recognizes the need to provide smaller public companies with time to implement section 404's requirements. SEC's proposed approach of initially only requiring non-accelerated filers to submit an assessment by management of the company's internal controls over financial reporting makes sense. Allowing smaller companies additional time to provide the required auditor's attestation report will allow for a smoother transition into full compliance and will allow companies, and their auditors, time to implement forthcoming SEC and PCAOB guidance.

SEC should carefully evaluate the timing of the auditor attestation deadline for non-accelerated filers. SEC should ensure that management and auditors have a reasonable chance to review and utilize the additional guidance issued by SEC and PCAOB. Additional guidance can only reduce the burden on small businesses of complying with section 404 if SEC provides enough time for companies and their auditors to actually implement the guidance.

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<sup>2</sup> Securities and Exchange Commission, *Internal Control Over Financial Reporting in Exchange Act Periodic Reports of Non-Accelerated Filers and Newly Public Companies* (Aug. 9, 2006) (Release Nos. 33-8731; 34-54295).

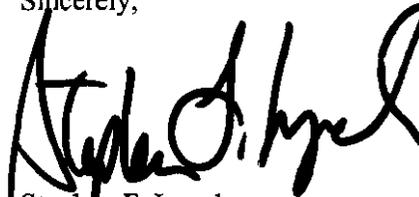
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**IV. SEC and PCAOB Should Consider a Multiple Year Approach**

SEC and PCAOB should seriously consider approaching internal controls testing requirements from a multiple year perspective. Various proposals have been made to reduce the required frequency of full-scale internal controls audits if a company first meets certain criteria.<sup>3</sup> This type of approach could reduce compliance costs while encouraging companies to implement and maintain strong internal controls.

I urge SEC to act swiftly to relieve the burden imposed by Sarbanes-Oxley section 404 in a manner that maintains the integrity of the Act's investor protections. Thank you for your consideration.

Sincerely,

A handwritten signature in black ink, appearing to read "Stephen F. Lynch". The signature is stylized and cursive.

Stephen F. Lynch  
Member of Congress

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<sup>3</sup> Robert Pozen, *Participant Statement for Roundtable on Section 404 of Sarbanes Oxley* (May 10, 2006); House Financial Services Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises, Testimony of NYSE Chairman Marshall N. Carter, *America's Capital Markets: Maintaining Our Lead in the 21st Century*, 109th Cong. (April 26, 2006).