



October 3, 2005

Via Facsimile and Electronic Mail

Chairman Christopher Cox
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-9303

Re: 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 (70 Fed. Reg. 56,825).

Dear Chairman Cox:

The Office of Advocacy of the U.S. Small Business Administration (Office of Advocacy)¹ submits these comments on the U.S. Securities and Exchange Commission’s (the Commission) release, *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*.² Advocacy supports the Commission’s decision to adopt the recommendations of its Advisory Committee on Smaller Public Companies (Advisory Committee), and believes that the Commission has provided a reasonable time for smaller public companies to evaluate the new regulatory requirements for reporting on internal controls of financial statements and for the Advisory Committee to collect information on the likely impacts of such requirements and make final recommendations.

I. Extension of Compliance Date.

The Office of Advocacy agrees with the Commission’s extension of compliance date for non-accelerated filers from the first fiscal year ending after July 15, 2005, to the first

¹ Congress established Advocacy in 1976 under Pub. L. No. 94-305 to represent the views and interests of small business within the Federal government. Pub. L. No. 94-305, 90 Stat. 663, §§ 201 et seq. (codified at 15 U.S.C. §§ 634a-g). Advocacy is an independent office within the Small Business Administration (SBA), so the views expressed by Advocacy do not necessarily reflect the views of the SBA or the Administration. Advocacy has a statutory duty to monitor and report to Congress on agencies’ compliance with the Regulatory Flexibility Act (RFA). Regulatory Flexibility Act of 1980, Pub. L. No. 96-354, 94 Stat. 1164, §3(a) (1980) (codified as amended at 5 U.S.C. § 612).

² *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*, 70 Fed. Reg. 56825 (Sep. 29, 2005).

fiscal year ending after July 15, 2006.³ The Advisory Committee has solicited oral and written testimony from affected entities, their counsel and auditors, and other market participants as to the likely effects of the new internal controls reporting requirements. This testimony found “overall consensus” that:

The costs of implementing Section 404 have been far more expensive than originally forecast and these costs are disproportionately larger for smaller companies. In addition to the actual costs, because of the newness and complexity of the rules, companies have had to expend considerable management time and effort to establish and attest to the effectiveness of their internal control over their financial reporting.

Letter from Herbert Wander and James Thyen, Co-Chairmen of the SEC Advisory Committee on Smaller Public Companies, to Christopher Cox, Chairman, U.S. Securities and Exchange Commission (Aug. 18, 2005) (attachment, Advisory Committee, *Resolution Regarding Section 404 Compliance Dates For Non-Accelerated Filing Companies* (Aug. 10, 2005)).

The Commission established the Advisory Committee as an independent advisor to weigh the evidence and make recommendations. Commendably, the Commission has chosen, after due deliberation, to act on those recommendations. The Office of Advocacy respects the Commission’s actions with regard to smaller public companies, and strongly approves of the Commission’s extension of the compliance date for the Commission’s new internal control requirements.

II. Internal Controls Over Financial Reporting.

The Commission requested comments on the question of whether there should be a different set of internal controls over financial reporting requirements for smaller public companies and whether there should be a different audit and attest standard for smaller public companies. The Office of Advocacy believes that the Advisory Committee may ultimately conclude that smaller public companies should not be subjected to the new requirements for audited internal controls of financial reporting. It appears that the new audit attest costs for internal controls are higher for smaller public companies than larger ones as a percentage of revenues. In addition, preliminary data indicates that smaller public companies are not enjoying the marked reduction of 50-60% from first year compliance costs that very large companies are.⁴ Testimony received to date by the Advisory Committee seems to indicate that much of these costs stem not from the need to establish new internal controls, but from the need to hire expensive outside professionals to attest to the sufficiency of these internal controls under penalty of law. Small public company representatives have stated that they believe that the newly expanded civil and criminal liability of corporate officers for statements made in reports will suffice to ensure that reports on internal controls are accurate without the need to require additional, expensive outside audits. The Office of Advocacy concludes that there is a genuine issue

³ 70 *Fed. Reg.* 56825-26.

⁴ For example, Financial Executives International (FEI) found that in January of 2005, companies with less than \$100 million in revenues (1) were incurring costs at similar levels to companies with up to five times their revenues, and (2) were not experiencing the same 50-60% cost reductions that larger companies were enjoying. FEI, *Special Survey on Sarbanes-Oxley Section 404 Implementation, Exhibit A* (March 2005) (available online at http://www.fei.org/404_survey_3_21_05.cfm).

of fact as to whether small entities would be better served by separate internal control standards or by reliance on corporate attestations, and the Office of Advocacy will defer to the expert opinion of the Advisory Committee in its final recommendations.

III. Small Business Size Standard.

The Office of Advocacy was pleased to see the Advisory Committee making preliminary recommendations to the Commission on proper size standards for regulation of small public companies. As the Commission is aware, the existing Commission small business size standard of less than \$25 million in revenues and market float has not been adjusted for inflation or market changes since 1992.⁵ The Office of Advocacy appreciates the Commission's consideration of the Advisory Committee's recommendations, looks forward to consulting with the Commission on any new small business size standard.⁶ The Office of Advocacy will likely defer to the Advisory Committee's expertise as to market participation and smaller public companies, but the Office of Advocacy does urge both the Advisory Committee and the Commission to avoid any changes to the definition which would make it too difficult for the Commission to reasonably and accurately identify the number of small issuers being subjected to regulatory requirements for RFA purposes.

IV. Compliance Cost Estimates.

The Office of Advocacy is aware of some detailed studies on actual compliance costs collected by surveying corporate officers and reviewing public data. The first is the above referenced FEI survey of Section 404 compliance costs. This survey, first conducted in 2004, breaks survey responses into revenue categories (including for companies with less than \$100 million), and has been updated quarterly over the past year.⁷ Second, Foley and Lardner conducted a compliance cost survey in 2005 that includes information for companies with less than or more than \$1 billion in revenues, and contains qualitative statements from corporate officers on the effects of the Commission requirements on their relationships with auditors and others.⁸ In addition, Foley and Lardner attorneys have published another study which analyzes existing data on audit fees and documents the disproportionate impacts of new requirements on small- and mid-cap issuers.⁹

⁵ 57 Fed. Reg. 36442, 36443 (setting the definition based on revenue and market float levels at 17 C.F.R. § 240.12b-2).

⁶ 5 U.S.C. § 601(3) (agency may set size standard different from the general SBA size standards "after consultation with the Office of Advocacy of the Small Business Administration and after opportunity for public comment.")

⁷ FEI, *FEI Survey on Sarbanes-Oxley Section 404 Implementation* (available online at http://www.fei.org/404_survey_3_21_05.cfm).

⁸ Foley and Lardner, *The High Cost of Compliance* (July 18, 2005) (executive summary available online at http://www.foley.com/publications/pub_detail.aspx?pubid=2849).

⁹ Thomas Hartman, *The Cost of Being Public in the Era of Sarbanes Oxley* (June 16, 2005) (available online at http://www.foley.com/publications/pub_results.aspx?searchType=Articles&keyword=&topicID=&practiceID=51&industryID=&serviceID=).

V. Conclusion

The Office of Advocacy is encouraged by the Commission's ongoing dedication to ensuring that its regulations reflect a reasonable balance between the needs of investors concerned with fraud at large corporations and the special concerns of small issuers who could suffer disproportionate costs in a one-size-fits-all approach to regulation. The Office of Advocacy supports recent steps by the Commission, including the extension of the compliance date for internal controls reporting, and looks forward to the final recommendations of the Advisory Committee. Thank you for your consideration and please do not hesitate to contact Michael See with any further questions at (202) 619-0312 or Michael.See@sba.gov.

Sincerely,

/s

Thomas M. Sullivan
Chief Counsel for Advocacy

/s

Michael R. See
Assistant Chief Counsel