

August 19, 2002

Mr. Jonathan G. Katz
Secretary
U.S. Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549-0609

**Re: Certification of Disclosure in Companies' Quarterly and Annual Reports
Rule**

Dear Secretary Katz:

I am writing to comment on the U.S. Securities and Exchange Commission's Notice of Proposed Rulemaking, "Certification of Disclosure in Companies' Quarterly and Annual Reports."¹ The proposed rule implements Section 302 of the Sarbanes-Oxley Act of 2002, requiring corporate officer responsibility for public company audit procedures and financial accuracy.² The Office of Advocacy of the U.S. Small Business Administration (Advocacy) commends the U.S. Securities and Exchange Commission (SEC) on its regulatory analysis of the proposed rule's impacts on small businesses.³ As required by the Regulatory Flexibility Act (RFA), the SEC's analysis includes alternatives to alleviate the proposed rule's disproportionate regulatory burdens on small businesses.

Advocacy was established pursuant to Pub. L. 94-305 to represent the views of small business before Federal agencies and Congress. The RFA, as amended by the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA), gives small entities a voice in the rulemaking process. The RFA requires Federal agencies, such as the SEC, to consider alternatives to avoid overly burdensome regulation of small entities.⁴ Advocacy is also required by Section 612 of the RFA to monitor agency compliance with the RFA.⁵

Advocacy commends the SEC for their effort in creating a plain English certification form. Advocacy would like to work with the SEC to ensure that the certification form remains simple so that small businesses can easily comply with the certification requirements.⁶

¹ Published in the *Federal Register* on June 20, 2002, replaced by the Supplemental Information published in the *Federal Register* on August 8, 2002.

² Pub. L. No. 107-204, 116 Stat. 745 (2002) (Sarbanes-Oxley Act).

³ The SEC estimates that 2500 small businesses are registered under the Securities Act of 1933. The SEC's definition of "small business" includes firms with less than \$5 million in net assets. 17 C.F.R. § 240.0-10(a).

⁴ Pub. L. No. 96-354, 94 Stat. 1164 (1981) (codified as amended at 5 U.S.C. §§ 601-612).

⁵ 5 U.S.C. § 609.

⁶ However, we do recommend that SEC clarify the appropriate instruction heading on each of the registration forms to read "Signature, Certification and Filing of Report" rather than the current "Signature and Filing of Report."

Advocacy respectfully submits the following comments on the pending SEC rulemaking.

I. Additional Small Business Considerations

In addition to the certification form, Advocacy offers for the SEC's consideration two further alternatives to significantly reduce burdens on small businesses while achieving the goal of full and fair disclosure.

First, Advocacy encourages the SEC to allow small businesses sufficient lead time to properly certify their financial statements and their internal audit controls. Second, because smaller companies generally do not alter their internal controls from quarter to quarter, we suggest that the SEC allow small businesses to renew their previous report upon a company's review of the controls and a finding of no material changes.

A. Advocacy recommends a sufficient transition periods for small business

The SEC has devoted much time and effort to ensuring that the everyday investors in this country are provided with timely and accurate corporate information. Advocacy enjoys the opportunity to work with the SEC to reduce unnecessary regulatory burdens on small businesses while ensuring that investors are provided with full and fair disclosure.

Small businesses have limited financial reporting resources. For small businesses to provide accurate and full disclosure, Advocacy recommends that the SEC allow sufficient time for small businesses to begin certifying. Advocacy suggests that small businesses' certification begin with the first annual report filing for the fiscal year ending after the SEC's promulgation of regulations.

According to securities professionals and industry participants, small business registrants generally do not employ a permanent staff member charged with securities law compliance. We believe that small businesses should be given a grace period in which they can observe the lessons learned by larger firms that would immediately comply with the new disclosure requirements.

Confidence in small business is at an all-time high. In fact, the Wall Street Journal reported that 91% of Americans voice confidence in small business, nearly twice the level for larger corporations.⁷

Advocacy believes that a reasonable time period for initial compliance would allow for establishment of best practices by industry leaders.⁸ With these considerations in mind,

Advocacy believes that such a clarification would help principal officers to identify the instructions for certification and make clear that there would be a difference between the signature requirement and the certification requirement.

⁷ John Harwood, *Washington Wire*, WALL STREET J., at A-4 (July 26, 2002) (NBC News poll).

⁸ The Sarbanes-Oxley Act itself is silent as to the when SEC must require initial compliance. Sarbanes Act, at Section 302. It appears that SEC would be well within its regulatory discretion, as outlined in Section 2, to regulate within the "public interest" and consider disproportionate impacts this proposal could have upon small business, as required by the RFA. Sarbanes Act, Section 2.

Advocacy recommends that small businesses begin certifying with the first annual report filing for the fiscal year ending after the SEC's promulgation of regulations.⁹

B. Advocacy recommends a clarification from the SEC as to the need for small businesses to audit their internal control procedures each quarter

Advocacy believes that the Sarbanes-Oxley Act of 2002 does not require small businesses to perform an audit as to the effectiveness of their internal control procedures every 90 days.¹⁰ Advocacy notes that small businesses do not have full-time internal control officers and rarely, if ever, change their audit practices.¹¹ Advocacy recommends that the SEC require complete re-examination of audit procedures only upon a material change in the small businesses internal procedures.

Advocacy encourages the SEC to avoid the unintended burden of requiring small businesses to audit their audit procedures every 90 days.¹² As a market-wide cost, this financial burden would likely be passed on to investors and consumers, who would not receive useful information in return in most cases.

Advocacy suggests that a reasonable implementation of Section 302(a)(4)(C) would allow small businesses the ability to refer back to the last full evaluation, provided there has been no material change in the company's business or internal procedures. Allowing reference would guarantee the same level of investor disclosure (there have been no material changes), while reducing disproportionate burdens to small businesses. Therefore, Advocacy recommends that SEC expressly permit small businesses to rely upon previous analyses absent material change in circumstances.

⁹ Simply put, if a company's fiscal year were to end on December 31, 2002, the company would file its first certification with its annual report filed in the beginning of 2003, giving it around 120 days to set up sufficient internal controls and compliance regimes.

¹⁰ Section 302(a)(4)(C) of the Sarbanes-Oxley Act of 2002 simply requires the chief officers to evaluate "the effectiveness of the issuer's internal controls as of a date within 90 days prior to the report."

¹¹ In fact, internal controls are generally set at the time of registration, and left intact without change from quarter to quarter.

¹² Small businesses have recently seen a marked rise in audit fees. This year alone, fees have risen as much as 25%. In addition, auditors estimate that by next year their services will cost 15% to 25% more than this year. See Calmetta Coleman and Cassell Bryan-Low, *Audit Fees Rise, and Investors May Pay Price*, WALL STREET JOURNAL, at C1 (Aug. 12, 2002)(2002 WL-WSJ 3403227)(as firms lose consulting services, audit fees will rise), *Tough New World-The Pressure on Audit Firms*, THE ECONOMIST (Aug. 3, 2002)(2002 WL 7247022).

II. Conclusion

Advocacy appreciates the opportunity to provide its recommendations regarding the SEC's certification regulation. Thank you for your consideration and please do not hesitate to contact me or Michael See of my staff at (202) 205-6533 or Michael.See@sba.gov.

Thomas M. Sullivan
Chief Counsel for Advocacy

Michael R. See
Assistant Chief Counsel for Advocacy

Cc: Martin P. Dunn, Deputy Director, Division of Corporate Finance
Elizabeth M. Murphy, Chief, Office of Rulemaking, Division of Corporate Finance
Mark A. Borges, Special Counsel, Division of Corporate Finance