SOCIETY OF CORPORATE SECRETARIES
& GOVERNANCE PROFESSIONALS

April 3, 2006

Advisory Committee on Smaller Public Companies
c/o Nancy M. Morris,
Federal Advisory Committee Management Officer,
Securities and Exchange Commission
100 F Street, NE,
Washington, DC 20549-1090

Ladies and Gentlemen:

Re: Release Nos. 33-8666; 34-53385; File No. 265-23

The Society of Corporate Secretaries & Governance Professionals (the "Society") appreciates the opportunity to respond to the request for comments made by the Advisory Committee on Smaller Public Companies (the "Advisory Committee") in its February 28, 2006 release entitled "Exposure Draft of Final Report of Advisory Committee on Smaller Public Companies" (the "Exposure Draft"). The Society, founded in 1946 as the American Society of Corporate Secretaries, has over 3,800 members representing approximately 2,600 companies. Its members are responsible for public disclosure under the securities laws and matters affecting corporate governance. Most of the members' companies are public companies and many of those companies would be significantly affected by adoption of the recommendations of the Advisory Committee.

Our members are involved personally with all of the tasks required to comply with securities laws and the listing requirements of the New York Stock Exchange, the American Stock Exchange, and NASDAQ and have had leading roles in their companies in implementing the requirements of the Sarbanes-Oxley Act ("SOX") and the related rules adopted by the Commission and the exchanges. Based on that experience, we support generally the recommendations contained in the Exposure Draft and the underlying rationale for those recommendations which would be particularly beneficial in mitigating the cost of compliance with Sarbanes-Oxley without seriously diminishing investor protection:

There are certain aspects of the Exposure Draft where we have concerns about the conclusions or believe there is a need for further clarification:

- Revenue Filters – The Exposure Draft allows "microcap" and "smallcap" companies to opt-in to one of two differing methods of compliance with SOX §404. While the primary standard for establishing these two tiers of smaller companies is based on their respective market capitalization, the availability of these alternate §404 compliance rules is further limited by a revenue cap. Microcap companies with product revenues of $125 million or more (and smallcap companies with revenues in excess of $10 million) would not be eligible for the conditional relief from compliance with the audit requirements of 404 proposed in Recommendation III.P.1. Smallcap companies and microcap companies with revenues in excess of $125 million would similarly not be able to avail themselves of the limited relief from compliance with §404 in Recommendation III.P.2 if their revenues were $250 million or greater. The exposure draft posits that these revenue levels establish that the business of the company is so complex that the more informal assurances of integrity of the financial statements can no longer be relied upon and these companies should therefore bear the full burden of §404 compliance. In fact, in our experience revenue does not equate to complexity. Many businesses operate on very modest margins between their raw materials or suppliers and their revenues. Obvious examples are contractors and distributors—most of their revenues, which can be substantial, come "in-the-front-door" and quickly go "out-the-back-door" to vendors and subcontractors. The underlying business is not, as a result, inherently complex. The revenues of certain other businesses are highly dependent on the price of one or two commodity raw materials which can fluctuate widely depending on world market conditions. These businesses may have significant revenues because they pass-through raw material costs, but have simple business models with small net income. We believe the market takes into account all of these factors when establishing a market capitalization, and that as a result, market capitalization is a more sophisticated and appropriate measure.

While we believe revenues are a very poor predictor of complexity, and should not be used to determine eligibility for either of these two Recommendations, if the Advisory Committee determines to recommend a revenue cap, then it should be derived from the percentage-of-the-market concepts similar to those incorporated in Recommendation II.P.1 or add alternative inflation adjustment criteria. Any flat dollar limit will, in a few years, become obsolete as a result of inflation as has happened repeatedly with other dollar limit provisions contained in the rules of the Securities and Exchange Commission. Without a self-adjusting cap, the opportunity for significant cost savings contained in Recommendations III.P.1 & 2 will annually disappear for some significant fraction of the covered companies even though their economic situation has not changed in inflation-adjusted real dollar terms.

- <u>Opt-in Feature</u> – We are concerned that auditing firms will continue to be very concerned about their potential liability and that they will place extraordinary pressure on their audit clients to "opt-out" of Recommendations III.P.1 & 2. Thus, the substantial benefits of these Recommendations (assuming their adoption by the Securities and

Exchange Commission) will be lost for many smaller companies. We suggest that the Advisory Committee buttress these recommendations with language whereby the Commission would make clear that auditors do not incur additional litigation risk by allowing their clients to implement a Recommendations III.P.1 & 2.

- Collapsing Regulation S-B into Regulation S-K – Because of the very low dollar limits which have existed for eligibility to use Regulation S-B, few of our members or their companies have been able to avail themselves of its provisions. The Exposure Draft also indicates that many advisors to companies eligible to use S-B are reluctant to allow those companies to take advantage of it. We believe this is in part because those companies would then present financials which the market would view as an aberration because they are so rarely seen. Thus it is difficult to know whether consolidating S-B into S-K will actually result in a cost savings to the increased number of companies who would be eligible to use the equivalent of the S-B rules incorporated into S-K or whether market forces will tip companies toward full S-K compliance. Having two separate standards, especially for the financial statements, is probably not a significant benefit for smaller companies if they are rarely ever used and setting up two standards in Regulation S-K risks adding complexity and confusion to the rules. Given this uncertainty, we would suggest that the Advisory Committee consider either—

    - a pilot program which retains the current S-B (or the modified version with two years of balance sheets as proposed in the Exposure Draft) for the class of microcap companies which would evaluate whether there is significant usage of the separate standard, or

    - simply adopting a two year rule on balance sheets and income, cash flow and change in shareholders' equity statements for all microcap and smallcap public companies and allow the market to determine whether it is acceptable for companies to omit the third prior year from certain types of public disclosures, such as offering documents. As noted in the Exposure Draft, all of the prior year information is now easily accessible through various web-based sources.

- Transition Rules – We believe that further guidance is needed from the Advisory Committee detailing how the transition rules will work for companies that meet the qualifications for the exemptive relief provided in the Exposure Draft. The Exposure Draft currently contemplates allowing the SEC to follow precedent in drafting the transition rules and cites examples of such transition rules, including rules regarding movement to and from Regulations S-B and S-K, non-accelerated and accelerated filer status and well-known seasoned issuer eligibility and non-eligibility. We believe that the cited transition rules do not provide the proper structure to the exemptive relief provided in the Exposure Draft. Specifically, previous transition rules have contained provisions that require additional disclosures upon reaching certain thresholds (such as moving from Regulation S-B to Regulation S-K) and other transition rules utilize guidelines that are difficult to attain when moving to a less restrictive set of rules (such as moving from accelerated to non-accelerated filer status). Thus, we propose that the Advisory Committee recommend the following general guidelines for the SEC to follow when drafting the transition rules:

- *When moving from a category that has more exemptive relief to a category with less (or no) relief (i.e., a company's market capitalization increases), companies should be allowed to rely on the prior years' relief.* By making relief permanent, the company would not be forced to provide any additional compliance testing or financial data for prior years once a new, higher threshold has been reached. This "bright line" provides assurance to small companies and eliminates the incentive (to both the company and its auditors) to preemptively perform such testing or auditing of financials, which would eliminate the benefit of relief.

- *When moving from a category that has less exemptive relief to a category with more exemptive relief (i.e., a company's market capitalization decreases), companies should be allowed to immediately use such exemptive relief (and consequently rely on such relief on a permanent basis);* <u>provided, however, that one condition is met:</u> the company has met the market capitalization threshold by ten percent or more. This ten percent capitalization requirement eliminates having companies that are near thresholds jumping in and out of categories on a yearly basis due to market fluctuations, while allowing companies whose market capitalizations have had a large financial decrease to immediately utilize exemptive relief.

- <u>COSO Framework</u> –The Advisory Committee's Recommendation III.S.1 regarding the COSO Framework and AS2, while categorized as a secondary recommendation, is, in fact, fundamental to achieving a cost-effective system for assessing internal controls. As indicated in the Exposure Draft, we also do not believe that the current version of COSO's revised guidance for smaller companies will result in any meaningful change in the burden of compliance with AS2. Thus, it is essential that COSO substantively revise the Framework in the context of smaller companies and, in particular, address the issue of materiality which, in practice, has become a very low threshold for assessing the effectiveness of internal controls in smaller public companies.

As noted above, the Society endorses the recommendations in the Exposure Draft to address the significant differences between smaller and larger companies and the very large unexpected financial burden that is falling on the smaller companies. These companies are, as noted in the Exposure Draft, the primary generators of new jobs in the US economy. As currently structured, the regulatory burden falls disproportionately on the smaller companies and makes them less able to compete with either their US-based competitors or their ex-US competitors of any size. The impact is clearly demonstrated by the rush of new offerings to London to avoid this burden. Thus, there is a real need for the Advisory Committee's recommendations to be adopted to avoid placing smaller US companies and US markets at a competitive disadvantage.

We applaud the work of the Advisory Committee. The quality of the work product, the depth of analysis and the reflection of practical realities in the Exposure Draft is of great value to the marketplace.

Respectfully submitted,

SOCIETY OF CORPORATE SECRETARIES AND GOVERNANCE PROFESSIONALS

By: Barbara L. Blackford, Chair, Task Force on Smaller Public Companies

cc: Pauline Candaux, Society Securities Law Committee Chairperson
William Mostyn, Society Chairman-Elect
David W. Smith, Society President
Susan Ellen Wolf, Society Chairman