October 31, 2005

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

File No. S7-06-03

Sent via email to: rule-comments@sec.gov

Dear Mr. Katz,

Financial Executives International's ("FEI's") Small Public Company Task Force ("SPCTF") is pleased to respond to the Securities and Exchange Commission's (SEC's) Request for Comment on implementation of Section 404 of the Sarbanes-Oxley Act by non-accelerated filers included in "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" (Release No. 33-8618).

FEI is a leading international organization of 15,000 members, including Chief Financial Officers, Controllers, Treasurers, Tax Executives and other senior financial executives. The SPCTF reviews and responds to statements, pronouncements, pending legislation and proposals issued by agencies and organizations. This document reflects the views of FEI's SPCTF, and not necessarily those of FEI.

FEI's SPCTF appreciates the SEC's decision to further delay, until fiscal years ending on or after July 15, 2007, the compliance deadline for non-accelerated filers to file their internal control reports required under Sarbanes-Oxley Section 404, as set forth in the final rule which was also included in SEC Release No. 33-8618.

In response to the Request for Comment included in SEC Release No. 33-8618, we are attaching a copy of our August 31, 2005 comment letter previously filed with the SEC by FEI's SPCTF. Additionally, we refer you to the September, 2005 report of the Financial Executives Research Foundation (FERF), entitled "FEI Survey Results: Internal Control over Financial Reporting Issues Affecting Small Public and Private Companies," which is available at: http://www.fei.org/rfbookstore/PubDetail.cfm?item_id=230.

Due to the very short comment period (30 days) on SEC Release No. 33-8618, we could not readily gather more information from our membership, but we believe our August 31 comment letter and the FEI survey referenced therein will be responsive to the Request for Comment. We have also reminded our membership of the comment deadline in our newsletter, FEI Express, which goes to all of our members.

Thank you for considering our views. We would be happy to discuss this further at your convenience or respond to any questions you may have. Please feel free to contact Serena Dávila at the FEI Washington, D.C. office at (202) 626-7809 or myself at (510) 774-1969 should you have any questions.

Sincerely,

Richard D. Brounstein
Chairman of the Small Public Company Task Force
Financial Executives International, and
Member of the SEC Advisory Committee on Smaller Public Companies

ATTACHMENT

August 31, 2005

Mr. Jonathan G. Katz
Secretary
U.S. Securities and Exchange Commission
100 F St. N.E.
Washington, D.C. 20549

File No. 265-23
Sent via email to: Rule-comments@sec.gov

Dear Mr. Katz,

Financial Executives International's ("FEI's") Small Public Company Task Force ("SPCTF") is pleased to provide responses to the "Request for Public Input by Advisory Committee on Smaller Public Companies" (Release No. 33-9599, or the "Questionnaire") issued for public comment by the Securities and Exchange Commission ("SEC") Advisory Committee on Smaller Public Companies (the "SEC advisory committee") on August 2nd, 2005.

FEI is a leading international organization of 15,000 members, including Chief Financial Officers, Controllers, Treasurers, Tax Executives and other senior financial executives. The SPCTF reviews and responds to statements, pronouncements, pending legislation and proposals issued by agencies and organizations. This document reflects the views of FEI's SPCTF, and not necessarily those of FEI.

The Questionnaire asked respondents to indicate what they had in mind as a reference point or definition of "small company". As a rough guide, and in line with the definition of small public company recently adopted by the SEC advisory committee, our responses are based on an assumption of "small companies" being those with under an approximate $700 million market cap, and "microcaps" being those companies with under an approximate $100 million market cap.

Chief among our comments is that we urge the SEC to act as soon as possible to implement the recommendations contained in the letter sent by the SEC advisory committee to Chairman Cox on August 18, which were:

1. To delay the compliance date of Section 404 of the Sarbanes-Oxley Act ("Section 404") an additional year for non-accelerated filers (to fiscal years ending on or after July 15, 2007. (Additionally, FEI's SPCTF believes the measurement date for determining whether a company falls under the non-accelerated vs. accelerated filer category should be as of the first day of a company's fiscal year with respect to that year's year-end reporting requirements.)
2. To not impose the final phase-in of accelerated filing dates for Form 10-K and Form 10-Q on smaller companies, and to consider applying the definition of smaller companies agreed upon by the SEC advisory committee. The SEC advisory committee's definition of "smaller companies" also directs that the measurement date for determining annually if a company meets the definition of "smaller company" for reporting purposes should be specified such that a

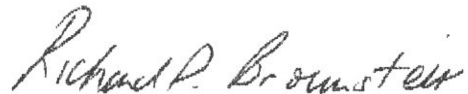
company will know on the first day of its fiscal year whether it falls under the definition of “smaller company” for that fiscal year.

Our detailed comments are included in the Attachment. We believe the information contained in our responses can help the SEC advisory committee form additional recommendations to present to the SEC and as applicable to the Public Company Accounting Oversight Board (PCAOB) which can significantly reduce the burden on smaller public companies in implementing 404 while still achieving the intended benefit and meeting the SEC’s overarching goal of investor protection.

As noted in our June 6 comment letter to the SEC, we wish to reiterate our support for the spirit of the Sarbanes-Oxley Act, and we strongly support the efforts of the SEC advisory committee.

Thank you for considering our views. We would be happy to discuss this further at your convenience or respond to any questions you may have. Please feel free to contact Serena Dávila at the FEI Washington, D.C. office at (202) 626-7809 or myself at (510) 774-1969 should you have any questions.

Sincerely,



Richard D. Brounstein
Chairman of the Small Public Company Task Force
Financial Executives International, and
Member of the SEC Advisory Committee on Smaller Public Companies

ATTACHMENT

Below are the detailed comments of Financial Executives International's ("FEI's") Small Public Company Task Force ("SPCTF") in response to the "Request for Public Input by Advisory Committee on Smaller Public Companies" (Release No. 33-9599, or the "Questionnaire") issued for public comment by the Securities and Exchange Commission ("SEC") Advisory Committee on Smaller Public Companies (the "SEC advisory committee") on August 2nd, 2005.

We have focused our responses on certain of the items included in the Questionnaire. The Question number references below correspond to the Question numbers in the Questionnaire.

1. **Has SOX changed the thinking of smaller companies about becoming or remaining a public company? If so, how?**

Smaller companies are consciously aware of the challenges of Sarbanes-Oxley Section 404 ("404") not only in terms of direct cost but also the indirect cost (opportunity cost) of the drain on management's and employee's intellectual resources that would otherwise be put into product development and marketing in the business units, and other analysis and recommendations that would normally be part of what the financial and compliance staff provide to the company.

We believe these costs greatly exceed the benefits of 404 in the first year and pose a significant challenge in subsequent years as well, and we provide data to support this view in our response to Question 14 below.

To provide the best opportunity for small public companies to develop and grow, and remain such an integral part of the economy, we believe it is imperative that the SEC act as soon as possible to implement the recommendations contained in the letter sent by the SEC advisory committee to Chairman Cox on August 18, as detailed further in our response to Question 3 below.

3. **Do you believe SOX has enhanced, or diminished, the value of smaller companies? Please explain.**

We believe the gross imbalance between costs and benefits for small companies in implementing 404 (as supported by data we provide in response to Question 14, below), particularly in the first year of implementation but continuing in a slightly lesser degree in succeeding years, has diminished the value of smaller companies. This diminished value is evidenced not only in direct terms like downward pressure on cash flow and retained earnings, but also indirectly by diminishing the ability of small companies to compete and remain viable under the heavy burden of 404.

Therefore, we strongly urge the SEC to act as soon as possible to implement the recommendations contained in the letter sent by the SEC advisory committee to Chairman Cox on August 18. Those recommendations, and our support for those recommendations, are detailed below.

Delay 404 Compliance Date for Non-Accelerated Filers an Additional Year

FEI's SPCTF supports the SEC advisory committee's recommendation to delay the compliance date of Section 404 an additional year (to fiscal years ending on or after July 15, 2007) for non-accelerated filers.

Additionally, FEI's SPCTF believes the measurement date for determining whether a company falls under the non-accelerated vs. accelerated filer category should be as of the first day of a company's fiscal year with respect to that year's year-end reporting requirements.

The delay in the compliance date of Section 404 will provide more time for small companies (non-accelerated filers) to take advantage of lessons learned - at great cost - by larger companies, particularly since larger companies generally already had more highly developed internal control systems, documentation, and testing in place than most smaller companies do and are now working toward.

In addition, the "learnings" being experienced by large companies and their audit firms continues, as they consider how the SEC's and PCAOB's May 16 guidance will impact the work performed by company management and outside auditors in this second year of implementation for them, and if the impact will be limited, to consider whether further guidance is needed.

Furthermore, we believe it is highly probable that additional recommendations will be issued by the SEC advisory committee with respect to the SEC's and PCAOB's rules implementing Section 404 before the SEC advisory committee wraps up its work at its slated conclusion date of April 23, 2006. The April 23, 2006 date is set forth in the SEC advisory committee's Charter, which describes the objectives of the SEC advisory committee as including an assessment of, and to make recommendations for changes with regard to, four areas affecting small public companies, the first of which relates to internal control reporting under Section 404, including the related management report and auditor's report thereon.

As the SEC advisory committee continues to make recommendations with respect to management's reporting and the related auditor's report under Section 404, the SEC and PCAOB will need time to engage in any rulemaking or other guidance that is recommended by the SEC advisory committee.

Do not impose final phase-in of accelerated filing deadlines on smaller companies

FEI's SPCTF strongly supports the recommendation of the SEC advisory committee that the SEC should not impose the final phase-in of the accelerated filing deadlines for 10-Ks and 10-Qs on smaller companies. We believe there would be little if any benefit to investors from the shortening of the deadline, versus allowing companies sufficient time to have confidence they are providing the highest quality reporting possible in the timeframe allowed.

Additionally, we believe the third recommendation sent by the SEC advisory committee to the SEC, regarding use of the definition of smaller companies agreed upon by the SEC advisory committee, is a useful approach with respect to implementing the second recommendation of the SEC advisory committee discussed immediately above, and potentially for other rulemaking impacting small public companies.

Going forward, we are hopeful some relief can be recommended by the SEC advisory committee, and acted on by the SEC and PCAOB, that will make the cost-benefit equation of complying with 404 more in balance and less onerous for smaller companies.

We include in the remainder of our responses to the Questions below, particularly our response to Question 14 below, some recommendations for the SEC advisory committee to consider adopting. By adopting such recommendations, the SEC advisory committee has the potential to have a real impact on public companies, small and large alike, in shaping a more sensible, efficient and effective approach to meeting the letter and spirit of Section 404.

10. **In developing a "risk-based" approach for assessing and auditing internal control over financial reporting for smaller companies under SOX Section 404, what criteria would you use to categorize internal controls from the highest risk to the lowest risk controls?**

    FEI's SPCTF also strongly endorses a risk-based approach to designing, implementing, assessing and as required, auditing, internal control over financial reporting. This is consistent with the recommendation of FEI's Committee on Corporate Reporting (CCR) in its comment letter to the SEC on April 1, 2005 as reiterated in the comment letter of FEI's SPCTF to the SEC on June 6, 2005.

    A risk-based approach places more emphasis on control environment and pervasive controls than on detailed documentation and testing of transaction and process level controls. Further, a risk-based approach focuses resources on controlling and monitoring areas that present the highest risk to financial reporting (e.g. where accounting rules are complex, highly judgmental estimates are involved, the opportunity for management override exists, etc.)

12. **Current standards require that the auditor must perform enough of the testing himself or herself so that the auditor's own work provides the principal evidence for the auditor's opinion. Are there specific controls for smaller companies for which the auditor should appropriately be permitted to rely on management's testing and documentation? Are there specific controls for smaller companies where this is particularly not the case?**

    FEI's SPCTF, as noted in our letter to the SEC dated June 6, 2005, and consistent with the letter of FEI's Committee on Corporate Reporting ("CCR") sent to the SEC April 1, 2005, have taken the position that the auditor should be allowed to rely more on cumulative knowledge obtained through prior audit work, as well as to rely more on work performed by the client, particularly testing work conducted by "objective and competent" individuals. However, PCAOB Auditing Standard No. 2's ("AS2's") "principal evidence" requirement and walkthrough requirements take away from the ability of auditors to fully effect the efficiencies envisaged by the SEC's and PCAOB's May 16 guidance.

14. **Do the benefits of SOX Section 404 outweigh its costs for smaller companies? Please explain. Would you support a total exemption from SOX Section 404 requirements for smaller companies? Why or why not? Would such an exemption have a negative effect on investors' interests or perception regarding smaller companies? Why or why not?**

    At this time, we would like to respond only to the first question included in the multi-part question for Question 14 above. FEI's SPCTF believes there has been a gross imbalance between cost and benefit under Section 404. Although we strongly support having a strong control environment and internal control over financial reporting, we believe the approach conducted to date in implementing Section 404, an approach that has largely been driven by auditors' views – influenced, in part, and understandably so, by auditor's liability concerns – has resulted in overkill as far as following the letter and spirit of Section 404. Equally important, the lack of a true risk-based approach, and the inordinate focus on documentation and testing of detailed transaction and process level accounts that pose low risk, but take time, money, and focus away from higher risk areas, can drive a result that is actually inconsistent with the purpose of Section 404 which its Congressional framers had in mind, to build investor confidence and strengthen financial reporting.

    In March, 2005, FEI surveyed its members on both the costs and benefits of Section 404. 217 public companies of all sizes responded, and the survey results (summarized in the tables that follow) clearly demonstrated a disproportionate cost burden on smaller companies, with questionable benefit.

Cost of Section 404 – Based on Sales Revenue

Companies with sales revenue of:	Amt spent on 404 compliance[1]	404 cost as % of avg. sales rev
$25 million - $99 million	Over $800,000	1.29%
$100 million to $499 million	Over $1.5 million	0.50%
$500 million to $999 million	Over $2.1 million	0.28%
$ 1 billion to $4.9 billion	Over $4.3 million	0.14%
$ 5 billion to $24.9 billion	Over $9.0 million	0.06%
Over $25 billion	Over $14.7 million	N/A (no "avg" available)

Cost of Section 404- Based on Market Cap

Companies with market cap of:	Amt spent on 404 compliance[1]	404 cost as % of avg market cap
Under $75 million	Over $1.0 million	2.67%
$75 million to $699 million	Over $1.5 million	0.39%
Over $700 million	Over $5.8 million	N/A (no "avg" available)

Benefits of 404

Although important benefits were cited by respondents of all sizes to FEI's March 2005 survey; the costs were generally believed to exceed the benefits by most companies. Additionally, the benefits were generally disproportionately lower for smaller companies, particularly in the $100 million - $1 billion revenue range[2], vs. larger companies, as shown in this excerpt from the results of the FEI March 2005 survey, below.

Benefits attained

Benefits Occurring Under Section 404	Percent of companies citing particular benefits listed, by size of company (size defined by annual sales revenue)					
	$25 million $99 million	$100 million – $499 million	$500 million- $999 million	$1 billion- $4.9 billion	$5 billion- $24.9 billion	Over $25 billion
Financial Reports:						
More Accurate	40.0%	33.3%	22.6%	32.4%	37.1%	45.5%
More Reliable	40.0%	42.2%	29.0%	35.2%	48.6%	63.6%
Helped Prevent or Detect Fraud	33.3%	20.0%	16.1%	22.5%	34.3%	36.4%
More Investor Confidence in Financial Reports	60.0%	47.7%	53.1%	49.3%	83.3%	83.3%

[1] Total internal costs, outside consultants and external audit fee related to 404.

[2] NOTE: The March 2005 FEI Survey results captured benefits information by size of company based on revenue. Comparable information was not compiled based on market cap. However, in relative terms, the "small companies" in the $100 million - $1 billion sales revenue range are deemed a rough equivalent for "small companies" which FEI's SPCTF defines in this comment letter to the SEC as being companies with under an approximate $700 million market cap (excluding microcaps which FEI's SPCTF defines as companies with under an approximate $100 million market cap).

To bring greater balance to the cost-benefit equation, keeping in mind the SEC's goal of investor protection and our desire to support that goal by making implementation of 404 more efficient and effective, FEI's SPCTF respectfully submits for the SEC advisory committee's consideration the recommendations described below.

Safe Harbor Needed for New/Upgraded IT Systems, Certain Other Items

The SEC's and PCAOB's May 16, 2005 guidance failed to adequately address concerns raised at the SEC's public roundtable on April 13, 2005 regarding the negative effect Section 404 is having on companies' ability to conduct timely implementation of certain key business decisions, particularly installation of new or upgraded Information Technology (IT) systems. As described in testimony given to the SEC at its public roundtable on April 13, and as cited in the comment letter filed by FEI's Committee on Corporate Reporting (CCR) April 1, 2005, and reiterated in FEI's SPCTF comment letter filed with the SEC on June 6, 2005, the express requirements of the SEC's and PCAOB's rules under Section 404 as they have been interpreted by issuer companies, and particularly by the audit firms, has caused companies to delay installation or upgrades of IT systems, as well as certain other business decisions.

Companies are hesitant to install new or upgraded systems in the last half of the year, and the 4th quarter in particular. This reaction is not because of any lack of confidence in the control aspects of those systems, but because the specific requirements of AS2, as implemented by the audit firms, pose too much risk that something will be found to be a significant deficiency or material weakness due to, e.g., the timing of audit testing and sampling techniques engaged in by the audit firms, and the technicalities of AS2's definitions and requirements, which do not give adequate credence to, e.g., compensating controls (including manual controls), nor does AS2 allow sufficient weight to be given to related substantive testing.

The need for further guidance from the SEC and/or PCAOB, including a safe harbor for installation of new or upgraded IT systems, was further evidenced in the results of a survey of small public companies conducted by FEI's SPCTF in June, 2005, regarding various internal control over financial reporting issues. "Small" for purposes of this survey was defined as companies with less than $500 million in sales revenue, and the 54 small public companies responding to the survey were about evenly split among accelerated and non-accelerated filers[3]. An overwhelming majority of respondents to the June 2005 FEI's SPCTF survey said that timing of installation of new or upgraded IT systems was impacted by 404. In addition to IT systems, other business decisions affected by 404 are listed below. (Numbers in parenthesis are % of accelerated filers, followed by % of non-accelerated filers, indicating the timing of the particular item was impacted by Section 404.):

- New or upgraded IT system (75%, 33.3%)
- IPO's (12%, 11.1%)
- Reverse mergers (4%, 0%)
- New lines of business (20 %, 18.5 %)
- New domestic locations (8%, 11.1%)
- New foreign subsidiary (28%, 14.8%)
- Change in auditors (40%, 18.5%)

The unforeseen impact of 404 on business decisions, in particular regarding the inability of companies to install new systems or upgrade systems due to practices that have developed around AS2, does not allow for U.S. companies to remain competitive and to put quality first. In some

[3] The 54 small public company respondents to the FEI SPCTF survey were about evenly split among accelerated (25 companies) and non-accelerated (29 companies) filers.

instances, older systems may even pose more risk to financial reporting, but un-economic decisions are resulting from what was described at the SEC advisory committee's August 9-10 meeting as auditor (and resultant client) "paranoia" over liability under AS2 and in general.

FEI's SPCTF comment letter of June 6, 2005, consistent with the comment letter of FEI's Committee on Corporate Reporting (CCR) of April 1, 2005, suggested a safe harbor period of at least one year for IT installations and upgrades be allowed, permitting such items to be scoped out of the determination of the effectiveness of internal control under Section 404 for a particular year. In addition, FEI's SPCTF June 6 comment letter recommended such a one year safe harbor also apply to joint ventures and start-up divisions. The need for a safe harbor provision for IT and other business decisions being negatively impacted by Section 404 was supported in the results of the June 2005 survey of small public companies conducted by FEI's SPCTF, in which most respondents agreed that a safe harbor of at least six months be allowed for IT and other affected business decisions they identified in the survey, as listed above.

Remove "More Than Remote" and "Could" from Definition of Material Weakness in AS2

FEI's SPCTF, as indicated in our comment letter to the SEC of June 6, 2005, believes the SEC's and PCAOB's May 16 guidance will be helpful and is moving everyone in the direction of a greater use of judgment and a "risk-based" approach to audit procedures. However, as also noted in our June 6 comment letter, there are still several areas in AS2 where judgment or a risk analysis is not permitted to be considered in determining auditing procedures.

We believe that chief among the reasons why a true top-down, risk-based approach to Section 404 still is not being achieved, is due to limitations imposed by the definition of material weakness set forth in PCAOB Auditing Standard No. 2 (AS2), on which so much else rests. To better conform the definition of material weakness to the SEC's and PCAOB's most recent (May 16, 2005) guidance, we recommend the term "more than remote" be removed from the definition of material weakness under AS2; a standard of "reasonably possible" would be more appropriate. Further, we recommend the word "could" be removed from the definition of material weakness under AS2, since use of the word "could" is driving unintended results of material weaknesses being found which "could" exist due to rote, mechanistic extrapolations of individual items deemed "control deficiencies," due to the requirement to assess if something "could" (not that it "did," but if it "could") cause a material weakness).

Importantly, FEI's SPCTF believes the changes to the definition of material weakness in AS2 recommended above will make Section 404 implementation more effective and efficient not only for smaller public companies, but also for larger public companies, and that our recommendation is in line with the recommendation of FEI's Committee on Corporate Reporting's (CCR's) comment letter to the SEC on April 1, 2005, to strive for a more principles-based approach to Section 404.

Provide Guidance to Appropriately Consider Issues of Scale Impacting Materiality for Smaller Public Companies

Small public companies, due to their smaller size, generally have an inherently lower scale of materiality. When extrapolating the effect of a control weakness such as, e.g. a lack of a triplicate copy of an invoice being in the appropriate file, the relatively small bottom lines, and even individual financial statement line items, often present at a smaller company can cause such control deficiency findings to be deemed material weaknesses. For the bottom line, this is exacerbated by non-cash charges such as expensing of stock options and other non-cash charges. A question arises, what does a company with a break-even bottom line do when gauging materiality, and is such a company (or a company with relatively smaller scale numbers in its financial statements) unfairly

disadvantaged vs. a larger company with a larger bottom line, for which many control deficiencies may fall below the threshold, individually or in the aggregate, of amounting to even a significant deficiency.

To address this issue regarding the reasonableness and meaningfulness of the approach to materiality for small public companies, we recommend the SEC issue guidance to bring about a reasonable, sensible and meaningful approach, one which will lessen the burden on smaller public companies, and provide more meaningful information to investors. The scale issue exacerbates and causes illogical results from what many may believe to be a presumption of direct proportionality; i.e., that all small problems at all small companies should be material. Common sense dictates there is a need to look at the impact extrapolation has on small companies with relatively small positive, negative, or break-even bottom lines, and relatively small line items in its financial statements.

Achieve Greater Balance in Reporting Implications of Lack of Documentation (of Effective Internal Control) vs. Lack of Effective Internal Control

Another point made in the comment letter of FEI's SPCTF dated June 6, 2005 was the continued impact of AS2 paragraph 138, which states that lack of documentation of the design of a control, or lack of evidence supporting management's assessment, is a control deficiency, the severity of which must be evaluated (e.g., as to whether that lack of documentation/evidence constitutes, in itself, a significant deficiency or material weakness).

Paragraph 138 of AS2 has resulted in a great deal of time, effort and money being expended to avoid an unintended consequence of potentially having to report, or actually having to report, a material weakness due to, e.g. lack of a particular piece of paper, or lack of a signature stamp on a particular piece of paper, relating to an internal control which was found to operate effectively, and where all related substantive audit work found no problems.

Requiring a company to reflect a material weakness due to the lack of documentation described above does not seem reasonable, and indeed would appear to be confusing to investors, who would try to evaluate the impact of that material weakness, vs. another company reporting a material weakness due a failure of internal control. It also does not appear consistent with a principles-based approach, which was recommended in the comment letter filed by FEI's Committee on Corporate Reporting (CCR) on April 1, 2005. Furthermore, disclosure alone (as to the nature of material weaknesses) is not enough of an antidote to the perception of illness caused by labeling a company as having a material weakness, regardless of severity.

To address this unintended consequence, which has resulted in excess cost being expended without sufficient benefit, and which has an undue negative impact on small public companies, we recommend the PCAOB rescind the requirement that a lack of documentation in and of itself be deemed a control weakness, or, at a minimum, that the PCAOB reiterate and reemphasize the guidance provided in paragraph 43 of AS2, that, "The form and extent of documentation will vary depending on the size, nature, and complexity of the company."

Allow Auditors to Rely More on Cumulative knowledge and on Client Testing

Another point made in the FEI SPCTF comment letter of June 6, 2005, and in FEI's Committee on Corporate Reporting (CCR) comment letter filed April 1, 2005, which we wish to reiterate once again, is the need for the PCAOB to issue guidance to allow auditors to rely more on cumulative knowledge from prior test work.

In addition, FEI's SPCTF recommends the PCAOB issue guidance to allow the auditors to rely more on the work of management, particularly test work conducted by competent, objective personnel. Although such reliance was incorporated into the SEC's and PCAOB's May 16, 2005 guidance, elements of AS2 still preclude optimal and sensible reliance on management's work, such as the principal evidence and walkthrough requirements, which we recommend be further refined to permit greater reliance on competent, objective test work conducted by the issuer companies personnel or 3rd parties.

Allow a Risk-Adjusted Scope for the Management Report, and/or the Auditor's Report, for Small Companies under Section 404

Although the PCAOB's Policy Statement issued May 16, 2005, and the SEC's Staff Statement issued May 16, 2005, both discouraged use of a "one-size-fits-all" approach to auditing companies under Section 404, and we appreciate such guidance, there may be some factors – particularly auditor's concern with liability, including from such things as a second-guessed judgment call (e.g., second-guessed by PCAOB's inspectors or the plaintiff's bar), or an unintentional mistake, vs. intentional collusion with allegedly corrupt management – that are continuing to drive certain "one-size-fits-all" practices by auditors, including use of "checklists" as additional armor to shield the auditor against potential liability.

In light of this concern, and to achieve greater balance between the costs and benefits of the Section 404 management report and audit, particularly for smaller public companies, as previously suggested in the comment letter filed by FEI's SCPTF on June 6, 2005, FEI's SPCTF recommends that the SEC consider clarifying the scope of management's assessment of the "internal control procedures" required under Section 404, to be directed at the Control Environment and Entity-level controls. Such controls have the greatest impact on internal control over financial reporting, and a scope directed at the Control Environment has the potential to facilitate a significant reduction in the expenditures being made on documenting and testing process and transaction level controls that pose less risk, and would be counteracted by an effective Control Environment. We will refer to this as a "risk-adjusted" scope for the management report. The PCAOB then would have to issue conforming guidance for the scope of the auditor's report to mirror the risk-adjusted scope of management's report to focus on the Control Environment. FEI's SPCTF believes this risk-adjusted scope for management's and the auditor's reports fulfill both the letter and spirit of Section 404.

If the SEC would not agree to risk-adjust the scope of management's report as described above, then FEI's SPCTF still recommends the PCAOB issue guidance to allow for such a risk-adjusted scope for the auditor's report.

Allow Some Reliance on Substantive Audit Work to Support the Assessment of Internal Control

Although the PCAOB's Policy Statement issued May 16, 2005 encourages movement toward a more integrated audit, FEI's SPCTF believes full realization of such an integrated audit is being stymied in part by AS2's prohibition against relying, even in part, on substantive audit work, to support the assessment of the effectiveness of internal control.

To address this unintended consequence, FEI's SPCTF recommends the PCAOB issue guidance to remove the prohibition currently contained in AS 2 paragraph 158, which states, …[T]he absence of misstatements detected by substantive procedures does not provide evidence that controls related to the assertion being tested are effective."

22. Are the listing standards of the New York Stock Exchange, the American Stock Exchange, other exchanges or Nasdaq that require a majority of independent directors and independent audit, nominating and compensation committees (or in the alternative, in the case of Nasdaq, that nomination and executive compensation decisions at a minimum be recommended or determined by a majority of the independent directors) creating a hardship for smaller companies? Are there benefits to companies and investors of these listing standards in the context of smaller companies? Do the hardships outweigh the benefits in the case of smaller companies? If so, should these standards be revised for smaller companies, and, if so, how? In each case please explain. Are smaller companies experiencing difficulty finding independent directors to satisfy these listing standards (including independent directors with the required level of financial literacy and sophistication for audit committee service)? What steps are being undertaken to meet these requirements?

We would like to respond to the last two questions contained in Question 22 above.

In response to the specific question as to whether smaller companies are experiencing difficulties finding independent directors to satisfy listing standards we would like to provide the following results from the survey of small public companies conducted by FEI's SPCTF in June 2005: 84% of the small public company accelerated filers, and 86% of the small public company non-accelerated filers, indicated they would find it difficult to obtain independent board members (or additional independent board members). The biggest reason given for such difficulty, particularly in finding appropriately qualified independent board members for the audit committee, was concern about potential liability on the part of the potential board member, followed by cost of directors' fees and difficulty obtaining qualified audit committee members in the local area (or from outside the local area willing to travel). Similar results were obtained in Foley & Lardner's study published June 16, 2005, which noted, "It continues to be increasingly expensive for companies of all sizes to attract and retain qualified directors."

With respect to the question about "what steps are being undertaken to meet these requirements," we would like to note that FEI has maintained a Director's Registry, available at http://www.fei.org/careers/registry.cfm to assist our members (and nonmembers, as a public service) in identifying qualified board and audit committee members.

However, there may be a need for further flexibility in the listing requirements – for instance, requiring an independent audit committee (but not 100% independence) and allowing less than 50% independent directors for smaller companies – but requiring a reasonable percentage of independent directors. Further, smaller companies rely more on directors in a consultant role, in addition to a compliance role. The $60,000 limitation and 3-year transition window could be re-examined. We believe certain limited exceptions, with appropriate disclosure, may also be appropriate.

The objective should be transparency. Adding independence to a Board is a significant move in this regard. Requiring that all public companies issue timely 10-Qs and 10-Ks with financial – if not 404 audits – for even the microcaps, is, in our opinion a significant improvement to allowing certain companies to "go dark."

27. Will the phase-down to the final accelerated reporting deadlines for periodic reports under the 1934 Act for companies with $75 million market capitalization (ultimately 60 days for Form 10-K and 35 days for Form 10-Q) be burdensome for smaller companies? If so, please explain the manner and extent of this burden. Does the burden outweigh benefits to investors and markets for smaller companies?

We strongly urge the SEC to adopt, as soon as possible, the recommendations agreed upon by the SEC advisory committee at its August meeting described under our response to Question 3 above, including the recommendation that the SEC not require the final phase-in of the accelerated filing deadlines for smaller companies.

As further evidence for this request, we note that over 66% of the small public company respondents to the June, 2005 survey of small public companies conducted by FEI's SPCTF said they would have difficulty meeting the final phase-in of the accelerated filing deadlines for 10-Ks and 10-Qs. The difficulties they said the would face included additional cost/staffing (44% of accelerated filers, 48% of non-accelerated filers) and the need to more time to adequately review the financial statements to ensure their quality (28% of accelerated filers, 39% of non-accelerated filers).

Additionally, FEI's Committee on Corporate Reporting (CCR) sent a letter to the SEC on July 20, 2005 recommending the SEC not move to the final phase-in of the accelerated filing deadlines on quarterly Form 10-Q, stating, "We believe the impact and challenges of meeting these quarterly deadlines are significant for both small and large companies." FEI's SPCTF seconds that notion and adds that for small public companies, there will be difficulty meeting the accelerated filing deadline for both the Form 10-K and Form 10-Q.