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June 29, 2007

The Honorable John F. Kerry
Chairman
Committee on Small Business & Entrepreneurship
428A Russell Senate Office Building
United States Senate
Washington, DC 20510-6350

Dear Chairman Kerry:

Thank you for your letters following up on some of the issues you raised during your hearing at the Committee on Small Business and Entrepreneurship concerning the Sarbanes-Oxley Act of 2002. I appreciate the Committee's strong interest in the phased-in application of the internal control over financial reporting requirements mandated by Section 404 for smaller companies.

I am pleased to report that the Commission and the Public Company Accounting Oversight Board have approved new guidance and a new auditing standard to reduce the cost and improve the quality of compliance with the Section 404 requirements. The Commission's interpretive guidance for management on how to conduct an evaluation of internal control over financial reporting for purposes of its management report under Section 404(a) is now final, as are our amendments to the Section 404 rules to provide assurance to management relying on the interpretive guidance that it has conducted an adequate evaluation. On June 12, the Commission published the PCAOB's new auditing standard in the Federal Register for notice and comment, and our intent is to act on this new auditing standard by no later than July 27.

These recent actions, together with the four successive extensions of the compliance deadlines that the Commission has granted for smaller public companies, will make it possible for smaller public companies to furnish only a management report – and not an auditor's report – in their first year of Section 404 compliance (which would be 2008 for calendar-year end companies). As a result, these smaller public companies will not have to provide a Section 404 auditor report on internal control over financial reporting until nearly two years from now.

Multiple benefits will inure to smaller companies as a result of the deferral of the auditor report deadline until 2009. Non-accelerated filers will not have to pay for an auditor report on internal control over financial reporting streamlined for another full year. The auditors will gain more than a year's worth of experience with the revised auditing standard in connection with their audits of larger companies before they begin to audit these smaller companies' internal controls. And smaller companies' management will be able to conduct the first management evaluation without the added pressure that accompanies a separate attestation by the auditor.

Concerning the potential for a shortage of auditors and consultants as non-accelerated filers begin to comply with the Section 404 requirements, I can assure you that, as we did in 2004, we will work closely with the PCAOB and senior executives at the audit firms to monitor accounting resources. We do not, however, anticipate that there will be a shortage of qualified professionals when the non-accelerated filers begin to comply with the Section 404 rules.

The final Commission release adopting amendments to the Section 404 rules contains a Cost-Benefit Analysis and Final Regulatory Flexibility Analysis. In addition, the Commission intends to prepare and publish a staff analysis that will examine the anticipated benefits and costs of 404 implementation once the Commission has completed its public exposure and consideration of the new auditing standard. This analysis will be completed well before the Section 404(b) compliance deadline for smaller companies in 2009.

The Commission also complied with the Small Business Regulatory Enforcement Fairness Act. Our Interpretive Guidance serves as a plain-language compliance guide to the Commission rules implementing Section 404(a) of the Sarbanes-Oxley Act. While the Interpretive Guidance may be relied upon by any reporting company, we believe that it will be especially useful to management of smaller public companies. We are also undertaking to provide a brochure especially for small companies to further assist them in complying. And as always, staff members of the Commission's Office of Chief Accountant and Office of Small Business Policy within the Division of Corporation Finance will provide informal guidance and assistance to smaller public companies and their auditors as the need arises. Also, the PCAOB is undertaking to provide a guide specifically for auditors of small companies to further facilitate efficient implementation of the new auditing standard.

Finally, you inquired whether the SEC's Advisory Committee on Smaller Public Companies could report regularly on the financial impact of Section 404. Unfortunately, this will not be possible because the Advisory Committee dissolved upon the expiration of its term and submission of its final report to the Commission. Nevertheless, both the Commission and the PCAOB will continuously consult with smaller public companies as we closely monitor compliance costs on an ongoing basis, and we will continue to work to lower the costs for smaller public companies to comply with the Sarbanes-Oxley Act while still preserving the investor protections that are central to the Act.

In addition to our actions to improve and rationalize Section 404 implementation for smaller public companies, the Commission recently approved the publication of six separate proposals to modernize and improve many of the capital-raising and disclosure and filing requirements that apply to smaller companies and to private offerings. I have also directed the staff to advise the Commission on possible amendments to the Commission's rules that relate to the shareholder threshold that triggers registration under Section 12(g) of the Securities Exchange Act of 1934, as you have requested. I have directed the Commission's Office of Economic Analysis to undertake a review of the Section 12(g) registration standards to determine whether they continue to be the most appropriate means of accomplishing the objectives of Section 12(g). We will keep you apprised of any future action that we decide to take to amend these rules.

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Thank you again for sharing with us the Committee's concerns with the implementation of the Sarbanes-Oxley Section 404 requirements for smaller public companies. We appreciate your interest in these matters and share your commitment to maintaining a regulatory environment that encourages the capital formation that is so essential to the growth of small business.

Sincerely,


Christopher Cox
Chairman