



January 26, 2006

Via Facsimile and Electronic Mail

Herb Wander
Co-Chairman
SEC Advisory Committee on
Smaller Public Companies
525 W. Monroe Street
Chicago, IL 60661-3693

James Thyen
Co-Chairman
SEC Advisory Committee on
Smaller Public Companies
1600 Royal Street
Jasper, IN 47549-1001

Re: Advisory Committee on Smaller Public Companies' Draft Recommendations.

Dear Messrs. Wander and Thyen:

The U.S. Small Business Administration's Office of Advocacy ("Advocacy") is submitting this letter to compliment the U.S. Securities and Exchange Commission's ("SEC") Advisory Committee on Smaller Public Companies' ("Advisory Committee") recent draft recommendations. Advocacy supports the Advisory Committee's draft recommendations as a reasonable approach to ensuring that securities regulations do not have unintended consequences for small businesses, and Advocacy respectfully provides additional recommendations for the Advisory Committee's consideration.

As an initial matter, Advocacy appreciates the hard work and dedication exhibited by the members of the Advisory Committee. The Advisory Committee's membership reflects a remarkable level of expertise and experience, and Advocacy believes that the Advisory Committee's policy determinations and final report deserve considerable deference. Advocacy's recommendations are limited to discussing other statutory small business protections which may interact with the Advisory Committee's recommendations, such as the Regulatory Flexibility Act of 1980 ("the RFA").¹ The RFA requires agencies to conduct regulatory

¹ *Regulatory Flexibility Act of 1980*, Pub. L. No. 96-354, 94 Stat. 1164 (1980) (codified as amended at 5 U.S.C. § 601 et seq.). Advocacy is charged under the statute with overseeing agency compliance with the RFA. 5 U.S.C. § 612.

flexibility analyses whenever their rulemakings would result in a significant economic impact to a substantial number of small entities. Such analyses include both an assessment of the economic impacts and a discussion of regulatory alternatives that could reduce or eliminate unnecessary economic impacts.²

To this end, Advocacy: (1) strongly supports the Advisory Committee’s recommendations regarding implementation of internal control and management reporting rules, and (2) recommends that the Advisory Committee address the application of the RFA in its small business size standard recommendation.

I. Advocacy Supports the Advisory Committee’s Recommendations Regarding Implementation of Section 404 Reports.

Pursuant to the RFA, the SEC should consider alternative regulatory approaches in implementing section 404 of the Sarbanes-Oxley Act of 2002 that could eliminate small business burdens. Advocacy supports the Advisory Committee’s recommendation that the SEC exempt smaller public firms from additional burdensome outside audit requirements. Advocacy has been contacted by small businesses faced with the initial and ongoing costs of securing outside audits of internal controls, and Advocacy shares the Advisory Committee’s concerns that disproportionate costs of capital for smaller public companies could force these companies out of markets entirely.

II. Small Business Size Standards.

Advocacy supports the Advisory Committee’s recommendation to update the existing SEC small business size standard to reflect changed market realities more accurately. As the comments and public testimony from smaller public companies bear out, the Advisory Committee has determined that differently sized companies will be affected by the implementation of section 404 in different ways and require regulatory flexibility. Specifically, the draft recommendations conclude that “Microcap Companies,” or those with less than \$125 million in market capitalization and revenues, should be afforded more regulatory flexibility than “Smaller Public Companies” that have between \$125 million and \$700 million in market capitalization and \$125 million and \$250 million in revenues, though smaller public companies would also require some regulatory flexibility. Small business size standards play an important role in how agencies treat small businesses under the RFA.

The RFA requires Federal agencies like the SEC to complete small business regulatory flexibility analyses—including consideration of costs and regulatory alternatives to reduce small business costs—when an agency determines that a rule would have a significant economic impact to a substantial number of small entities.³ The question of which businesses are actually included when the RFA refers to “small entities” is left to the Office of Size Standards of the U.S. Small Business Administration and the agencies themselves to define in their regulations by

² 5 U.S.C. §§ 603 (initial regulatory flexibility analysis), 604 (final regulatory flexibility analysis), and 605(b) (certification of rules that do not have a significant economic impact on a substantial number of small entities).

³ 5 U.S.C. § 605(b).

referencing size cutoffs relevant to the types of regulated entities.⁴ The SEC currently defines a small issuer as a company that had less than \$5 million in assets on the last day of its last fiscal year.⁵ In addition, for purposes of filing on the small business disclosure system, the SEC defines a small business issuer as having less than \$25 million in both revenues and public float.⁶

Advocacy suggests that any final recommendation of the Advisory Committee on a new size standard address the both the issue of small business flexibility in the implementation of section 404 and updates the SEC's size standards for RFA analysis and the way small public companies are treated. To this end, Advocacy recommends that the Advisory Committee's final report also propose the revision of both 17 C.F.R. §§ 230.157 (general RFA application) and 228.10(a)(1) (for purposes of Regulation S-B) to reflect the new size standard the Advisory Committee endorses. Advocacy generally supports the adoption of the Advisory Committee's \$125 million microcap size cutoff as the new small business size standard applicable to all SEC rulemakings, though it appears that adopting this size standard may require further reconciliation with current rules on accelerated filing and other size cutoffs.⁷

If you have any questions on this letter or related issues, please feel free to contact Michael See at Michael.See@sba.gov or (202) 619-0312.

Sincerely,

/s

Thomas M. Sullivan
Chief Counsel for Advocacy

/s

Michael R. See
Assistant Chief Counsel

cc: The Honorable Christopher Cox, Chairman, U.S. Securities and Exchange Commission
Gerald LaPorte, Chief, Office of Small Business Policy, U.S. Securities and Exchange Commission

⁴ 5 U.S.C. § 601.

⁵ 17 C.F.R. 230.157.

⁶ 17 C.F.R. 228.10(a)(1).

⁷ In addition, any change to the SEC's size standard regulation would require the SEC to consult with the SBA's Office of Size Standards. 5 U.S.C. § 601(3).