



February 25, 2008

Via Electronic Mail

The Honorable Christopher Cox, Chairman
U.S. Securities and Exchange Commission
Attn: Nancy M. Morris, Secretary
100 F Street, NE
Washington, DC 20549
Electronic Address: rule-comments@sec.gov

Re: Internal Control Over Financial Reporting in Exchange Act Periodic Reports of Non-Accelerated Filers (SEC File No. S7-06-03)

Dear Chairman Cox:

The Office of Advocacy (Advocacy) of the U.S. Small Business Administration (SBA) strongly applauds the Securities and Exchange Commission (SEC) for proposing a one-year extension of Section 404(b) of the Sarbanes-Oxley Act of 2002 for smaller public companies.¹ The proposed extension of the auditor attestation requirement will allow the SEC to complete a cost-benefit study of Section 404 for small companies, by analyzing companies currently complying with Section 404 under the SEC's newly-issued guidance for companies and auditors.² Advocacy commends the SEC Commissioners for their on-going dedication in the difficult process of implementing Section 404.

In 2007, Advocacy submitted numerous comment letters to the SEC, urging the agency to provide flexibility in Section 404 compliance for smaller public companies whose internal control reporting costs were likely to be disproportionately higher than larger public companies' costs.³ Advocacy recommended that the SEC extend the deadline for Section 404(b) to examine whether the SEC's newly-issued proposals were actually cost effective and to provide an additional year for small businesses and auditors to learn from the experience of larger companies. Advocacy is pleased that the SEC is considering the impact of Section 404 implementation on smaller public companies and for its continuing efforts to minimize the unnecessary costs for compliance.

¹ *Internal Control Over Financial Reporting In Exchange Act Periodic Reports of Non-Accelerated Filers*, 73 *Fed. Reg.* 7,450 (Feb. 7, 2008).

² Press Release, SEC, *SEC Begins Small Business Costs and Benefits Study of Sarbanes Oxley Act Section 404* (Feb. 1, 2008), available at: <http://www.sec.gov/news/press/2008/2008-8.html>.

³ For a complete chronology of Advocacy's Sarbanes-Oxley Act activities and comment letters, please visit our website at: http://www.sba.gov/advo/laws/comments/sarbanes_oxley.html.

I. The Office of Advocacy

Congress established the Office of Advocacy in 1976 by Pub. L. No. 94-305 to represent the views and the interests of small business within the federal government. Advocacy is an independent office within SBA, so the views expressed by Advocacy do not necessarily reflect the views of the SBA or the Administration. The Regulatory Flexibility Act (RFA),⁴ as amended by the Small Business Regulatory Enforcement Fairness Act (SBREFA),⁵ gives small entities a voice in the rulemaking process. For all rules that are expected to have a significant economic impact on a substantial number of small entities, federal agencies are required by the RFA to assess the impact of the proposed rule on small business and to consider less burdensome alternatives.⁶

II. Advocacy Supports the Section 404(b) Compliance Extensions for Non-Accelerated Filers

After the passage of the Sarbanes-Oxley Act of 2002, the SEC quickly realized the costs inherent in complying with Section 404 and delayed the implementation of Section 404 for small businesses. In 2005, the SEC chartered the Advisory Committee on Smaller Public Companies (Advisory Committee) to assess the impact of the Sarbanes-Oxley Act on smaller companies, and make recommendations for changes. Advocacy strongly supported the formation and work of the SEC's Advisory Committee, and encourages the SEC and other agencies to create similar independent advisory committees to analyze the impact of significant rulemakings on small entities. One of the Advisory Committee's key recommendations was that "unless and until a framework for assessing internal control over financial companies is developed that recognizes their characteristics and needs, provide exemptive relief from Section 404 requirements" to smaller public companies.⁷

On December 2006, the SEC and the Public Company Accounting Oversight Board (PCAOB) released their new "frameworks" for assessing internal controls that were created to make the Section 404 process more effective and efficient. The SEC later approved new management guidance and the PCAOB's revised auditing standard.⁸ After these proposals were released, Advocacy held a small business roundtable where many small business representatives commented that the SEC needed to provide further

⁴ *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.).

⁵ *Small Business Regulatory Enforcement Fairness Act*, Pub. L. 104-121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C. § 601 et seq.).

⁶ 5 U.S.C. § 603.

⁷ SEC Advisory Committee on Smaller Public Companies, Final Report of the SEC Advisory Committee on Smaller Public Companies (Apr. 23, 2006) (*Advisory Committee Report*), available at: <http://www.sec.gov/info/smallbus/acspc.shtml>.

⁸ *Management's Report on Internal Control Over Financial Reporting; Proposed interpretation; Proposed Rule*, 71 Fed. Reg. 77,635 (Dec. 27, 2006); *Proposed Auditing Standard-An Audit of Internal Control Over Financial Reporting that is Integrated with an Audit of Financial Statements and Related Proposals*, Release No. 2006-007 (Public Company Accounting Oversight Board, Dec. 2006), available at: http://www.pcaobus.org/Rules/Docket_021/index.aspx.

extensions to test if these guidance documents will actually result in scalability and cost savings for smaller public companies.⁹ Advocacy commends the SEC for following the Advisory Committee's recommendation by proceeding cautiously in implementing Section 404 for smaller public companies and for proposing this 404(b) extension to avoid unnecessary costs.

III. Advocacy Supports the SEC's 404(b) Cost-Benefit Study

Advocacy strongly supports the SEC's proposal to conduct a cost-benefit study and survey on the impact of Section 404 on smaller public companies. Advocacy is available to provide any assistance to the SEC with this study and survey, from reviewing draft materials to distributing surveys to the small business community.

Advocacy believes that the SEC's cost-benefit study on the impact of Section 404 on small public companies is important because other reports and studies have found that Section 404 imposes disproportionate costs on smaller public companies. A report by the SEC's Advisory Committee noted that Section 404 costs in relation to revenue will be disproportionately borne by smaller public companies. This report found that small public companies with a market capitalization of under \$100 million are expected to spend 2.55 percent of their revenue on Section 404 compliance, while larger companies with a market capitalization of over \$1 billion are expected to spend 0.16 percent of their revenue on such costs.¹⁰ A survey of actual compliance costs conducted by Financial Executives International in 2006 found that first-year compliance costs for Section 404 were \$3.8 million for accelerated filers and \$935,000 for smaller public companies or non-accelerated filers.¹¹

In the November 2007 *Cost of SOX 404 Survey* by the U.S. Chamber of Commerce's Center for Capital Markets Competitiveness, approximately nine out of ten respondents expect costs will "greatly exceed" or "moderately exceed" the benefits of Section 404 compliance.¹² The study found that over half of the respondents with public float of less than \$75 million expect internal and external costs to implement Section 404(a) this year to extend \$200,000 while forty-four percent of respondents expect implementation costs of 404(b) to also exceed \$200,000.¹³

According to the SEC, "in addition to assessing the Section 404 cost reductions resulting from the Commission's recent actions, the final report will inform any decision to improve the efficiency and effectiveness of Section 404 implementation."¹⁴ Advocacy

⁹ Small business concerns from this roundtable are summarized in a comment letter from Thomas M. Sullivan, Chief Counsel, Office of Advocacy, SBA, to the SEC and the PCOAB (Feb. 21, 2007), *available at*: http://www.sba.gov/advo/laws/comments/sec07_0221.html.

¹⁰ *Advisory Committee Report*, at 32.

¹¹ FEI, *Survey on SOX Section 404 Implementation*, Exhibit A: Costs by Filing Status (March 2006).

¹² U.S. Chamber of Commerce, Center for Capital Markets Competitiveness, *Cost of SOX 404 Survey 4* (Nov. 8, 2007). According to this survey, exactly 50% of the respondents describe their company's public float as \$75 million or less.

¹³ *Id.*

¹⁴ See Press Release, SEC, *supra* note 2.

recommends that the SEC carefully review the results of their study and survey, and provide additional flexibilities for smaller public companies if the results show that the costs of Section 404 outweigh the benefits for these entities.

IV. Regulatory Flexibility Act Considerations

SEC Should Revise its Final Regulatory Flexibility Analysis

Advocacy recommends that the SEC utilize the study and survey reports to complete a revised final regulatory flexibility analysis (FRFA) of the internal reporting requirements in accordance with Section 604 of the Regulatory Flexibility Act. The last regulatory analysis was completed on August 14, 2003, and that analysis severely underestimated the cost of compliance with Section 404 at \$35,286 per year.¹⁵ With current industry estimates of Section 404 compliance burden at almost \$1 million per year for small public companies, a new FRFA must be prepared to reflect the SEC's new data.¹⁶

SEC Should Utilize the Smaller Reporting Companies Definition for Its RFA Analysis

In December 2007, the SEC received approval from the Small Business Administration's Office of Size Standards for the small business definition of "smaller reporting companies" as companies with a public float of less than \$75 million.¹⁷ This new small business size standard combined the two major categories of smaller companies-- "small business issuers" (companies with a public float of less than \$25 million) and "non-accelerated filers" (companies with a public float of less than \$75 million) for "purposes of scaling our disclosure and reporting requirements to the needs of smaller companies and their investors."¹⁸ The SEC created this new size standard to simplify their rulemakings and to update the public float requirement to reflect the current market realities.

Advocacy believes that the SEC must utilize this size standard for RFA analysis to accurately assess the impact of Section 404 on small entities, as this rulemaking proposes extensions for companies with a public float of less than \$75 million. The SEC estimates that of the 11,898 companies that filed annual reports under the Exchange Acts in 2006, 4,976 companies had a public float of less than \$75 million.¹⁹ The SEC's Initial Regulatory Flexibility Analysis (IRFA) utilizes a definition of a "small business" or "small organization," which is defined as companies with total assets of \$5 million or less on the last day of its most recent fiscal year. The SEC's IRFA estimates that there only 1,100 issuers, other than registered investment companies, that may be considered "small

¹⁵ *Management's Report on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports*, Exchange Act Release No. 3308238; 34047986; IC-26068 (Aug. 14, 2003), available at: <http://www.sec.gov/rules/final/33-8238.htm>.

¹⁶ See Note 11.

¹⁷ *Smaller Reporting Company Regulatory Relief and Simplification; Proposed Rule*, 72 Fed. Reg. 39,670 (July 19, 2007). The new standard will be codified in 17 CFR 229.110(f)(1), replacing 17 CFR 228.10(f)(1).

¹⁸ *Id.*

¹⁹ *Smaller Reporting Company Regulatory Relief and Simplification*, 72 Fed. Reg. 39671 (July 19, 2007).

entities” affected by Section 404 under this definition.²⁰ Advocacy believes that the SEC must update its size standard for its RFA analysis, to accurately measure the numbers of small entities affected and the economic impact of this rulemaking on small entities.

V. Conclusion

Advocacy applauds the SEC for its continuing efforts to analyze the impacts of Section 404 on smaller public companies and to minimize the unnecessary costs of compliance. Advocacy urges the SEC to provide additional flexibilities for smaller public companies if the results of the agency’s study show that the costs of Section 404 outweigh the benefits for these small entities.

Advocacy is pleased to submit these comments on behalf of small businesses. If you should have any questions on this letter or related issues, please feel free to contact me or Janis Reyes at Janis.Reyes@sba.gov or (202) 205-6533.

Sincerely,

//signed//
Thomas M. Sullivan
Chief Counsel of Advocacy

//signed//
Janis C. Reyes
Assistant Chief Counsel

cc:

The Honorable Susan E. Dudley, Administrator, Office of Information and Regulatory Affairs
The Honorable Paul S. Atkins, Commissioner, U.S. Securities and Exchange Commission
The Honorable Kathleen L. Casey, Commissioner, U.S. Securities and Exchange Commission

²⁰ 73 *Fed. Reg.* at 7,453.