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Mr. Jonathan G. Katz
Committee Management Officer
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-0609

Re: File No. 265-23
Release No. 33-8571
Proposed Committee Agenda – Advisory Committee on Smaller Public Companies

Dear Mr. Katz:

BDO Seidman, LLP appreciates this opportunity to comment on certain portions of the proposed Advisory Committee agenda. Given the concerns that have emerged from the first round of companies that have adopted Section 404 internal control requirements, we believe the successful efforts of the Advisory Committee will be essential to ensure that the requirements for smaller public companies appropriately address the objective of investor protection in a practical and cost-effective manner.

Our comments focus on the following Committee agenda items:

- Definition of a Smaller Public Company
- Internal control reporting
- Disclosure requirements
- Accounting principles

Item 1 - Definition of a Smaller Public Company

We believe the Committee should consider the needs of companies of a wide range of sizes. Indeed, our comments in this letter address issues related to "smaller" public companies with market capitalization of up to $700 million.

One subset of that group is a company that meets the definition of a Small Business Issuer in Regulation S-B. To qualify for the somewhat abbreviated reporting requirements allowed for companies that meet that definition, a company must have revenues and a public float of less than $25 million. These thresholds were set when Regulation S-B was adopted in 1992. Given the inflation, economic growth, and increases in stock prices that have occurred since that time, we believe that it would be appropriate to raise those thresholds. We recommend that the Committee work with the Commission's Office of Economic Analysis to identify updated criteria for permitting a company to file as a Small Business Issuer.

Item 2 - Internal Control Reporting

We recommend that the agenda specifically address the timing of adoption of Section 404 requirements for smaller public companies, along with various adoption alternatives. Many of the problems experienced by companies in the initial year of adopting Section 404 were due to the short lead-time that companies and auditors were given to understand and implement the new requirements, and confusion over the scope of the requirements. Due to the significance of the first year implementation problems, we believe smaller public companies should be provided an additional one-year extension to July 15, 2007, to help minimize the adoption burden. This is important for the following reasons:

1. Ongoing human resource constraints will take time to address, and smaller companies in particular should not be unduly penalized due to resource issues.

2. Smaller companies are more dependent on third party technical tools and resources when adopting Section 404 requirements. There currently are not adequate tools and technical aids available that are tailored for smaller public companies, and we expect it will take time for these to become available.

Other adoption alternatives applicable to smaller public companies that we believe merit discussion in the agenda include:

A. Staggering or phasing in adoption. For example, companies could be required to report on the control environment element of the COSO framework in the first year, and other elements thereafter.

B. Easing the burden on new accelerated filers. Many smaller public companies will become accelerated filers for the first time in 2005. We believe that these companies should be allowed to provide their first internal control reports in accordance with the same deferred timetable as all other companies that were not required to report on internal control in 2004 (i.e., that they should be permitted to first report on internal control in 2006, rather than 2005).

C. Companies filing their first internal control reports should be allowed extra time to file them. We believe that an approach that would promote true integrated audits would be to provide extra time to file both the audited financial statements and the internal control reports in the first year. If the Commission is unwilling to permit companies extra time to file their audited financial statements, then the approach followed this year of allowing companies additional time to file internal controls reports should be continued, both in the initial year and in subsequent years.

In addition, we recommend that Item 2 of the agenda also include specific discussion of appropriate tools and practice aids that are desirable for use by smaller public companies, and how to best encourage their creation. The availability of standardized tools and practice aids is particularly important to smaller public companies to minimize the implementation burden in a low resource environment, and they are appropriate to use as a starting point since many smaller companies have common financial reporting processes and structures, and similar risks.

Item 5 - Disclosure Requirements

Definition of an Accelerated Filer

We believe that filing on an accelerated basis presents an undue burden for smaller public companies that the Committee should address. The complexity of today's accounting standards, the volume of disclosure requirements, and the requirement to report on internal control over financial reporting create an immense amount of work for the staffs of smaller public companies. Completing all of this work in the "regular" 90 days after year-end and 45 days after quarter-end due dates is very difficult. Compressing this work into shorter periods increases costs to smaller public companies by (a) forcing them to increase their staffs and (b) severely limiting the time their financial management can devote to "running the business" during the periods before periodic reports are due. Therefore, we have previously recommended to the Commission that it raise significantly the $75 million public float threshold that subjects an issuer to accelerated filing requirements.[1] We also believe that it should be easier for an accelerated filer that declines in size to be able to stop reporting on an accelerated basis.

Becoming an Accelerated Filer

In the Commission's September 2002 release accelerating the reporting deadlines for certain registrants,[2] the Commission stated that it designed the public float and reporting history requirements "to include the companies that are least likely to find such a change *overly burdensome* and *where investor interest in accelerated filing is likely to be highest*" (emphasis added). The Commission indicated that investor interest in accelerated filing is likely to be highest for companies followed by analysts and institutional investors because "[t]he more extensive information in periodic reports is evaluated by investors and particularly analysts and institutional investors as a baseline for the incremental disclosures made by a company." In addition, "investors, institutional investors and financial analysts" comprised the group of 20 commenters who supported acceleration as proposed.

[1] See our letters dated September 28, 2004 in Commission File No. S7-32-04 and January 31, 2005 in Commission File No. S7-38-04.

[2] Release No. 33-8128.

In connection with the Commission's *Securities Offering Reform* proposal,[3] its Office of Economic Analysis performed a study in which it identified issuers with wide market following. The OEA equated wide market following with "[h]igh levels of analyst coverage [and] institutional ownership," among other criteria. The study indicates that the market capitalization level at which issuers become widely followed is $700 million. Thus, the study also indicates that the market capitalization level "where investor interest in accelerated filing is likely to be highest" is $700 million, not the $75 million figure reflected in the current accelerated filer definition. The study also indicates that companies with market capitalizations of $700 million or more account for about 95% of U.S. equity market capitalization. Therefore, we strongly believe the study supports changing the $75 million market capitalization threshold that triggers accelerated filing to $700 million and that the Commission should do so. If an issuer is not widely followed, we believe the cost of meeting the accelerated filing deadlines is "overly burdensome" and exceeds the benefit.

Getting out of the Accelerated Filing System

Currently, once an issuer becomes an accelerated filer, it remains an accelerated filer until it meets the definition of a Small Business Issuer.[4] We believe that it should be easier for an accelerated filer that declines in size to be able to stop reporting on an accelerated basis. For example, we are aware of an accelerated filer whose market capitalization at the end of its second quarter was approximately $30 million, whose revenues for its latest fiscal year were less than $2 million, and who had 14 full-time employees. It seems clear to us that the costs to such a company (and its investors) of filing on an accelerated basis outweigh the benefits.

We do not believe an issuer's market capitalization temporarily falling below $700 million indicates an immediate loss of market following or that it should be immediately relieved of the requirement to file on an accelerated basis. However, we believe that the market capitalization level at which filing on a non-accelerated basis is justified is *substantially* higher than $25 million. We recommend that the Committee work with the Commission's OEA to identify more appropriate criteria for permitting a company to stop reporting on an accelerated basis.

Due Dates for Accelerated Filings

For the reasons discussed in our comments above regarding the definition of an accelerated filer, we recommend that the Committee consider the due dates for accelerated filings by smaller public companies. These due dates are scheduled to be reduced to 60 days after year-end for annual reports for fiscal years ending on or after December 15, 2005 and 35 days after quarter-end for subsequent quarterly reports.

As discussed above, we believe the Commission should change the definition of an accelerated filer so that companies with market capitalizations of less than $700 million can file in

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[3] Release No. 33-8501.

[4] See Exchange Act Rule 12b-2. To meet the definition of a Small Business Issuer, a reporting company must, among other things, have revenues and a public float of less than $25 million for two consecutive years.

accordance with the non-accelerated due dates (90 days after year-end and 45 days after quarter-end). If the Commission is unwilling to raise the public float threshold to the $700 million level or to revert to the 45/90 days due dates for quarterly and annual reports filed by issuers with market capitalizations in the $75-700 million range as we have recommended, we believe the results of the OEA's study of market following referred to above at least warrant retaining the current due dates for these issuers' periodic reports (40/75 days) and not accelerating them further (to 35/60 days).

Incorporation by Reference in Form SB-2

In its *Securities Offering Reform* proposal, the Commission has proposed amendments to Forms S-1 and F-1 that would allow Exchange Act registrants meeting specified criteria to incorporate by reference previously filed Exchange Act reports in Form S-1 or Form F-1. Given the high degree of access that market participants have to an issuer's financial information on the SEC's website, we no longer regard printing company information in a prospectus vs. incorporating it by reference as a substantive distinction. As such, we believe all Exchange Act registrants, including Small Business Issuers, should be able to incorporate by reference previously filed reports into Securities Act registration statements, including those filed on Form SB-2 (presuming, of course, that they have filed all required reports). We recommend that the Committee recommend this to the Commission.

Item 6 - Accounting Principles

"One Size Fits All" vs. "Big GAAP-Little GAAP."

We believe that "one size fits all" or "Big GAAP-Little GAAP" are diversions from a more fundamental and more important issue—the excessive complexity of recent accounting standards—that afflicts registrants of all sizes and their investors. We believe that the standards-setting process should be changed to issue standards that are easier to understand and remember and simpler to apply. After that is accomplished for the benefit of investors in all registrants, it would then be appropriate to consider whether investors in smaller public companies have different needs that would warrant differences in accounting standards.

We believe that generally all companies should follow the same recognition and measurement guidance, and that the differences for smaller companies principally should involve disclosure and transition. We believe different recognition and measurement guidance would increase cost and complexity for those involved with both larger and smaller companies — particularly independent accountants and users of financial statements—because of the need to learn two sets of standards. Different recognition and measurement guidance would also generate reporting issues and increased complexity for companies that change size because of organic growth or shrinkage or acquisitions or dispositions.

Every significant recent accounting standard—income taxes, derivatives, business combinations, variable interest entities, share-based payment, transfers of financial assets, etc.—has been long, complex, and full of narrow and highly specific requirements, some of which are costly to apply. The result has been the formation of a "secret society" for each pronouncement, composed of a few partners and managers from the national offices of the largest accounting firms, a few accountants from the largest corporations, and a few members of the FASB and SEC staffs. Those secret societies informally develop interpretations of the complex and narrow requirements of the standards, through discussions that would cause other accountants' eyes to glaze over. The most pervasive issues are codified as FASB Staff Positions or EITF consensuses, but most interpretations are published only by the largest accounting firms, if they are published at all. Other accountants, including other national office personnel at the major firms and corporations and other staff at the FASB and SEC, often are unaware of the issues and interpretations.

This situation of complex standards interpreted by secret societies is costly for registrants and sets up accountants to fail. Clearly it is a greater burden for accountants who serve smaller companies, because they are less likely to have access to members of the secret societies. What is less often recognized is that this arrangement also is costly for large registrants and a recipe for their accountants to fail as well. If accountants serving large registrants recognize that an issue exists, they have access to members of the secret societies. The issues in recent standards are so arcane, however, that accountants who aren't members of the secret society often don't recognize that an issue exists, and that the standard prohibits their intuitive approach. We could provide dozens of illustrations of the problem, but for purposes of this letter we will provide just one, relating to the most recent major standard, FASB Statement No. 123 (revised 2004), *Share-Based Payment*.

Statement 123 (revised) carries forward from prior accounting standards the requirement that when an enterprise receives an income tax deduction for the exercise of stock options (or the vesting of restricted shares) in a period that exceeds the compensation expense for that group of awards recorded in the financial statements, the excess tax benefit should be credited to shareholders' equity rather than to earnings. Because this is a familiar requirement, accountants may be lulled into a false sense of security. The FASB made two specific, narrow changes to past requirements that will catch many accountants by surprise and will be costly to implement:

The treatment of tax loss carryforwards

FASB Statement No. 109, *Accounting for Income Taxes*, establishes the general standard for recording the benefit of a tax loss carryforward—record the benefit if realization in the future is more likely than not. When original Statement 123 was issued in 1994, the FASB staff advised accountants to use the general Statement 109 requirements to record the benefit of tax loss carryforwards arising from tax deductions for option exercises (or vesting of restricted stock). In Statement 123 (revised), the Board prohibits recording the benefit of tax loss carryforwards arising from options or restricted stock; the benefit is recorded only when the carryforward is used. So, in Statement 123 (revised) the FASB has created an exception to its own general standard. Accountants need to become familiar with the new exception and need to remember two different approaches for recording tax loss carryforwards. Further, this change imposes costly new recordkeeping requirements. Registrants now need to separately identify and track loss carryforwards that arise from stock options (and restricted stock) versus other causes. Further, members of the secret society for income taxes believe that Statement 109 requires the tax loss carryforwards to be recorded for financial statement purposes in a different sequence than they are used under income tax law. So, registrants will need to track the use of loss carryforwards in two different ways for tax and financial statement purposes.

Presentation in the cash flow statement

In the past, the tax savings from deductions for stock options or restricted stock were recorded as part of operating cash flows, like all other income tax cash payments and receipts. Statement 123 (revised) requires the cash savings from *excess* tax deductions to be recorded as a financing cash inflow rather than as an operating cash inflow. Many accountants might initially think this is a simple reclassification, and that the amount of excess tax benefit recorded in shareholders' equity would be reclassified as a financing cash inflow. Alas, the requirements of Statement 123 (revised) are more complicated. The computation of how much excess tax benefit is recorded in shareholders' equity is performed on an aggregate basis for all options exercised and all restricted stock vested in a period. By contrast, the computation of how much excess tax benefit is recorded as a financing cash inflow is performed on an individual grant basis. So, registrants need to be aware of the change and need to make two different computations every period.

As noted earlier, these requirements are more burdensome for smaller registrants and their independent accountants, who have smaller accounting staffs and less access to the secret societies, but they are burdensome to all registrants. The risk of errors and the recordkeeping costs might be worthwhile if the new requirements created a significant benefit to users of financial statements. Our belief, however, is that most users of financial statements, not being accountants let alone members of a secret society, will be oblivious to the costly new requirements relating to loss carryforwards and to tracking individual grants in the cash flow statement and will obtain no benefit.

We believe it is possible to reduce the complexity of accounting standards and make them easier and less costly to understand, remember, and implement.

- *Make simplicity one of the considerations in establishing new standards*. The FASB should make simplicity one of its considerations in making decisions on new accounting standards. Today, simplicity is not a consideration. Reading the bases for conclusions, one finds that the Board makes decisions based on fidelity to the conceptual framework and the perceived usefulness to users of financial statements. Just as the FASB makes trade-offs between relevance and reliability, the FASB should make trade-offs between simplicity and other objectives. The FASB has begun a project to revise and update its conceptual framework. We believe that simplicity should be added to relevance and reliability as a key qualitative characteristic of accounting information.

- *Use existing or familiar principles, classifications, asset groupings, computations, etc. whenever possible.* When the Board addresses an issue that has precedents or parallels elsewhere in the accounting literature, we suggest a presumption that the Board build on the precedent or parallel unless a new classification, asset grouping, etc. has a substantial benefit. If the Board identifies a substantial benefit from introducing a new classification, asset grouping, etc., consider amending the prior requirements to conform, thereby maximizing the internal consistency of GAAP and minimizing the number of different requirements for accountants and users of financial statements to remember.

- *Amend existing standards to eliminate inconsistencies in principles, implementation guidance, computations, asset groupings, classifications, etc.* For example, choose one asset grouping for purposes of segment reporting, impairment of goodwill, and discontinued operations; develop a handful (fewer than five) of asset impairment models and conform the existing impairment guidance to one of the standard methods; and eliminate the differences in employers' accounting for one-time versus recurring employee compensation.

- *Standardize transition methods.* It would simplify the lives of both the Board and its constituents to develop a handful (fewer than five) of standardized transition methods and criteria for the use of each one.

Simplification of Accounting Principles

As noted previously, we believe the first priority should be to identify areas to simplify accounting principles for all registrants, not just smaller public companies. We believe the following topics are particularly difficult, meaning (a) a higher risk of error because the requirements are difficult to understand and remember, (b) costly to implement, or (c) both:

- Derivatives and hedging, including derivatives on a registrant's own shares
- Leases
- Retirement and termination benefits
- Share-based payment
- Income taxes
- Business combinations and goodwill
- Variable interest entities
- Transfers of financial assets
- Impairment of assets
- Revenue recognition

Extended Effective Dates for Future Accounting Principles.

Because smaller companies have smaller accounting staffs, we believe that extended effective dates are appropriate for the more complex or difficult-to-implement standards. This will allow smaller companies and their independent accountants to learn from the experience of the better-staffed, large registrants, which should make first-time implementation less costly for the smaller companies.

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We would be pleased to answer any questions the Committee might have about our comments and look forward to continued participation in the standard setting process. Please contact Wayne Kolins, National Director – Assurance Practice, at (212) 885-8595 or via electronic mail at wkolins@bdo.com, or Lee Graul, National Director – SEC Practice, at (312) 616-4667 or via electronic mail at lgraul@bdo.com.

Very truly yours,

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