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April 3, 2006

Ms. Nancy M. Morris
Federal Advisory Committee Management Officer
Securities and Exchange Commission
100 F Street, NE, Washington, DC 20549-1090

Re: Exposure Draft of Final Report of Advisory Committee on Smaller Public Companies File No. 265-23

Dear Ms. Morris:

BDO Seidman is pleased to provide our comments on the exposure draft of the Final Report of the Advisory Committee on Smaller Public Companies (the "Advisory Committee"). We believe the issues studied by the Advisory Committee, and specifically the application of Section 404 of the Sarbanes-Oxley Act of 2002 ("Section 404") to smaller public companies, are significant public policy matters, and we are glad to see the significant time and energy being focused on this important segment of our public capital markets.

We have chosen to focus the body of our letter on our views about internal controls at smaller public companies due to the importance of this issue. We also provide our views on certain of the Advisory Committee's specific recommendations in **Appendix 3** of this letter.

Internal Control Over Financial Reporting for Smaller Public Companies

We believe all public companies, including smaller public companies, should be required to maintain effective internal controls over financial reporting, including controls to prevent and detect fraud, and management of all public companies should be required to assess and publicly report on the effectiveness of those controls. We also believe that auditors should be required to provide some degree of assurance about such controls. For large public companies, the existing COSO framework and requirements of Auditing Standard No. 2, *An Audit of Internal Control Over Financial Reporting Performed in Conjunction with an Audit of Financial Statements* ("AS2"), is an effective approach, and does not require any significant changes or interpretations. However, there are many reasons why smaller public companies are different and why AS2 as currently written and even the COSO exposure draft on smaller public company reporting on internal controls may not be the most effective or efficient approach for them. We have included a list of differences we believe are important to consider in **Appendix 1** of this letter.

While Section 404 is producing significant benefits, the costs and burden of initial implementation and ongoing application are disproportionately affecting smaller companies. We believe the costs and burden will continue to be disproportionately higher for many smaller public companies due to the factors we have listed in Appendix 1. We also believe the costs and burden of Section 404 are particularly acute in certain industry segments, most notably emerging technology companies. The ability of these companies to succeed is primarily based on their ability to innovate, adapt, and remain nimble. However, the systems and processes necessary to comply with Section 404 as currently being implemented are not always consistent with these characteristics. In order to improve the cost-benefit equation, we believe it is essential to develop a right-sized, scalable approach to internal controls that is better suited to the unique needs of the smaller companies while still providing investors with the protection intended by Section 404.

There has been renewed focus recently on the needs of investors in smaller public companies and on how to best ensure they receive the protection intended by Section 404. Since investor protection through reliable financial reporting should be the primary goal of the participants in the financial markets, all participants must work together towards achieving that goal with respect to implementation of Section 404. In that regard, additional research, experimentation, and dialog with investors in smaller public companies is needed in order to determine the best course of action in fulfilling their needs. Accordingly, we believe it is premature to provide any category of public company with a permanent exemption from the internal control assessment or audit requirements of Section 404.

In order to develop the best course of action, we strongly recommend that the SEC establish and oversee a new broad-based task force that includes appropriate representation from smaller company investors and management, accounting firms, regulators, standard setters, as well as members from the existing Advisory Committee. The task force would be charged with reaching its conclusions by a definite and reasonable deadline, including pilot tests of various approaches, recognizing that while due deliberation is necessary to fully vet alternative solutions to the issues, solutions are needed as expeditiously as possible. We would be pleased to participate in this initiative. Until such a task force reaches its conclusions, we support continuation of the deferral for non-accelerated filers, as they are currently defined.

While a major focus of the task force would be developing targeted implementation guidance and tools for smaller public companies and their auditors, we also believe additional discussion regarding the nature of the auditor's attestation on controls should take place. The form of attestation issued has a significant impact on the nature and extent of work performed by the auditor and level of audit documentation that companies must prepare. Currently, companies' internal control assessments and documentation are largely driven by auditor requirements as prescribed by AS2. As a result, management's efforts to comply with Section 404 may be significantly more involved than they otherwise need to be for management to internally assess the effectiveness of controls. We believe the most productive discussions of the task force would balance the nature of the auditor's attestation on internal controls with improved guidance and tools for management that are not overly focused on auditability.

There are a number of approaches with respect to the nature of the auditor's attestation that should be explored in addressing how to achieve a more efficient and effective approach to internal controls for smaller companies. We are including a summary of several approaches for consideration in **Appendix 2** of this letter. We recommend additional study of these and other approaches by the task force, if established. In the event that a right-sized approach cannot be developed by the task force in an appropriate time frame, it may ultimately be appropriate to provide some form of exemptive relief for certain categories of smaller issuers.

In summary, we believe the question with respect to Section 404 is **how** it can be implemented in an efficient and effective manner at smaller public companies, and not **if** it should be implemented. Accordingly we believe that auditors, regulators, standard setters, investors and other stakeholders should work closely together to further consider alternative approaches and guidance for smaller public companies and to develop a right-sized, cost effective approach to implementing Section 404 that gives appropriate weight to investors' needs.

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Please refer to **Appendix 3** for our views with respect to certain of the Committee's specific draft recommendations. We would be pleased to answer any questions you have about our comments and look forward to continued participation in the standard setting process. Please contact Wayne Kolins, National Director of Assurance, 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,

BDO Seidman, LLP

Important Differences between Larger and Smaller Public Companies

Section 404 was enacted as a result of control related business failures at large companies that had widespread impact on investors, employees and other interested parties. Section 404 and the related auditing standards created to implement it were not designed with consideration of smaller companies, and the risk equation and cost-benefit analysis with respect to Section 404 generally appear to be significantly different for smaller companies than for larger ones. We believe the following differences and considerations are relevant for purposes of determining an appropriately scalable approach to internal controls at smaller public companies:

1. Managements of larger, more complex companies need to rely on strong systems and controls in order to ensure that financial data is reliable to effectively manage the business. The simpler organizational structure at smaller companies means top management is less reliant on systems and resultant detailed controls and more reliant on company-level controls, or controls performed by the CEO and CFO – i.e., “management’s daily interaction” – and on other people-based controls. While management’s daily interaction and other people-based controls may be an effective means of control for smaller companies, these types of controls are difficult for companies to sufficiently document and for the auditor to test.
2. AS2 is based on the premise of an integrated audit. However, smaller public companies often cannot obtain the same benefit as larger ones from the integrated audit concept. For auditors of larger, more complex companies, it is often both necessary and beneficial to place significant reliance on controls when performing the audit, since it is typically not practicable to substantively test detailed balances and transactions to the scope that would be required if reliance on controls were not warranted. However, for smaller companies with less complex environments, it is generally unlikely that the auditor will adopt an audit strategy of placing significant reliance on effective internal controls to reduce the scope of substantive testing. This occurs since there is less efficiency of scale at a smaller company and since it is more difficult for the auditor to establish that people-based controls can be relied on when system-based controls are not as strongly developed.
3. Smaller public companies generally do not have the same depth of internal resources as larger ones and typically do not have internal staff dedicated to understanding and implementing the latest accounting standards. As a result, smaller public companies are more dependent on external service providers, and qualified cost-effective external services are more difficult for these companies to secure in today’s resource-limited environment. In addition, smaller public companies are more dependent, within the constraints of the independence rules, on their audit firms for guidance with respect to financial reporting matters.
4. Due to increased importance of management’s daily interaction and the lack of depth of internal resources, top management of smaller companies generally is required to spend a greater proportion of time to initially achieve and subsequently maintain compliance with the requirements of Section 404 or hire resources to do this. These same members of top management are often central to the competitive success and well-being of smaller companies, and unduly burdensome compliance requirements have a direct negative effect on top management’s ability to focus on other aspects of the business.

Possible Approaches to Auditor Reporting that May be Considered

As discussed in the body of our letter, we believe additional discussion regarding the nature of the auditor's opinion on controls would be useful. The following are some approaches (and potential consequences of their adoption) that could be used and that should be considered, either separately or in combination:

1. Auditor Opinion on the Effectiveness of Internal Controls Over Financial Reporting

   - This is the current approach established by Section 404 and AS2.
   - Results in a uniform opinion for all public companies.
   - Not cost effective for some smaller public companies.

2. Auditor Opinion on the Design and Implementation of Controls

   - Recommended for consideration by the Advisory Committee.
   - Would likely result in decrease in cost and burden.
   - Different audit opinion for smaller public companies could possibly confuse investors.

3. Auditor Opinion on the Effectiveness of the Overall Control Environment

   - Company level controls and tone at the top are particularly important at smaller public companies due to the increased risk of management override and lack of segregation of duties.
   - Would likely result in decrease in cost and burden.
   - Different audit opinion for smaller public companies could possibly confuse investors.

4. Auditor Reporting of Identified Material Weaknesses without Reporting on Effectiveness

   - At smaller, less complex companies, the auditor typically performs more robust testing of transactions and balances for financial statement audit purposes, as noted in Appendix 1. As a result, the majority of material weaknesses at smaller public companies may be identified by the auditor without performing detail testing of controls.
   - The recently released audit risk assessment standards require that the auditor obtain a more in-depth understanding of the entity and its environment, including internal control, and could further enhance the auditor's ability to identify material weaknesses without performing detail testing of controls.
   - As a result of the above, this approach could focus on identification and reporting of material weaknesses, without requiring the auditor to specifically test or report on the effectiveness of controls.
   - This approach could allow management to take a more flexible approach to designing and documenting a company's controls, since management's approach would no longer be driven by auditability considerations.
   - Would likely result in decrease in cost and burden.
   - Different audit opinion for smaller public companies could possibly confuse investors.

Summary of BDO Positions on Advisory Committee Draft Recommendations

BDO's positions on certain of the Advisory Committee's draft recommendations are summarized in the following table (we have omitted recommendations of the Advisory Committee that we do not have a position on):

Advisory Committee Recommendations	BDO Position
Part III. Internal Control Over Financial Reporting	
Recommendation III.P.1: Unless and until a framework for assessing internal control over financial reporting for microcap and smallcap companies is developed that recognizes the characteristics and needs of those companies, provide exemptive relief from Section 404 requirements to microcap companies with less than $125 million in annual revenue and to smallcap companies with less than $10 million in annual product revenue that have or will expand their corporate governance controls to include: • adherence to standards relating to audit committees in conformity with Rule 10A-3 under the Exchange Act; and • adoption of a code of ethics within the meaning of Item 406 of Regulation S-K applicable to all directors, officers and employees and compliance with the further obligations under Item 406(c) relating to the disclosure of the code of ethics.	BDO does not support permanent exemption of the microcap or smallcap companies from the requirements of Section 404. Instead we recommend that implementation of Section 404 for non-accelerated filers as they are defined by the current rules under Section 404 continue to be deferred (microcaps over $75 million are not now deferred) until an acceptable alternative approach can be developed. We recommend a task force of appropriate parties be formed by the SEC to develop additional guidance and tools for smaller public companies, and to consider the appropriate level of auditor reporting on internal controls. In the event a right-sized approach for smaller companies ultimately cannot be developed, it may be appropriate to provide some form of exemptive relief from Section 404 to microcap companies.
Recommendation III.P.2: Unless and until a framework for assessing internal control over financial reporting for microcap and smallcap companies is developed that recognizes the characteristics and needs of those companies, provide exemptive relief from external auditor involvement in the Section 404 process to the following companies, subject to their compliance with the same corporate governance standards as detailed in the recommendation above: • smallcap companies with less than $250 million in annual revenue but greater than $10 million in annual product revenue; and • microcap companies with between $125 and $250 million in annual revenue.	BDO does not currently support permanent exemption of the smaller public companies from the external audit requirements of Section 404. We recommend a task force of interested parties be formed by the SEC to develop additional guidance and tools for smaller public companies, and to consider the appropriate level of auditor reporting in internal controls. In the event a right-sized approach for smaller companies ultimately cannot be achieved, it may be appropriate to provide some form of exemptive relief from the audit requirement to these companies.

Advisory Committee Recommendations	BDO Position
Recommendation III.P.3: While we believe that the costs of the requirement for an external audit of the effectiveness of internal control over financial reporting are disproportionate to the benefits, and have therefore adopted the second Section 404 recommendation above, we also believe that if the Commission reaches a public policy conclusion that an audit requirement is required, we recommend that changes be made to the requirements for implementing Section 404's external auditor requirement to a cost-effective standard, which we call "ASX," providing for an external audit of the design and implementation of internal controls.	We believe a number of alternative approaches should be considered by the task force we propose to help reduce the costs and burden to smaller public companies, including a possible change to the form of auditor reporting on internal controls as deemed acceptable by investors in those companies.
Recommendation III.S.1: Provide, and request that COSO and the PCAOB provide, additional guidance to help facilitate the assessment and design of internal controls and make processes related to internal controls more cost-effective; also, assess if and when it would be advisable to reevaluate and consider amending AS2.	We believe there is widespread general consensus on the need for additional internal control guidance for smaller public companies and support this aspect of the recommendation. We believe AS2 is currently effective for the larger public companies; however, we agree that the auditing and reporting requirements of AS2 should be reevaluated by the task force we propose for smaller public companies.
Recommendation III.S.2: Determine the necessary structure for COSO to strengthen it in light of its role in the standard-setting process in internal control reporting.	Because of the importance that COSO has in establishing standards with respect to internal controls, we support this recommendation to reevaluate its structure.
Part IV. Capital Formation, Corporate Governance and Disclosure	
Recommendation IV.P.1: Incorporate the scaled disclosure accommodations currently available to small business issuers under Regulations S-B into Regulation S-K, make them available to all microcap companies, and cease prescribing separate specialized disclosure forms for smaller companies.	BDO agrees with making the benefits of S-B available to microcap companies and eliminating S-B forms. We would prefer to leave the S-B rules separate (not integrate them into S-K). Instead, we recommend making greater use of the approach in General Instruction D.3 of Form S-4. We believe this is simpler and minimizes change.

Advisory Committee Recommendations	BDO Position
Recommendation IV.P.2: Incorporate the primary scaled financial statement accommodations currently available to small business issuers under Regulation S-B into Regulation S-K or Regulation S-X and make them available to all smaller public companies, including both microcap companies and smallcap companies.	See above response.
Part V. Accounting Standards	
Recommendation V.P.1: Develop a "safe-harbor" protocol for accounting for transactions that would protect well-intentioned preparers from regulatory or legal action when the process is appropriately followed.	We support this recommendation and believe it would also be appropriate for the safe harbor to apply to auditors.
Recommendation V.P.2: In implementing new accounting standards, the FASB should permit microcap companies to apply the same extended effective dates that it provides for private companies.	BDO supports this recommendation. Normally the reason the FASB provides an extended implementation for private companies is for cost/benefit reasons. This is based on the belief that larger companies will lead the way, enabling private companies and their auditors to be more efficient by learning from the experience of the initial implementation. The cost/benefit trade-offs seem similar for private and small public companies.
Recommendation V.P.3: Consider additional guidance for all public companies with respect to materiality related to previously issued financial statements.	BDO supports this recommendation for the reasons cited in the report.
Recommendation V.P.4: Implement a de minimis exception in the application of the SEC's auditor independence rules.	BDO supports this recommendation for the reasons cited in the report.
Recommendation V.S.1: Together with the PCAOB and the FASB, promote competition and reduce the perception of the lack of choice in selecting audit firms by using their influence to include non-Big Four firms in committees, public forums, and other venues that would increase the awareness of these firms in the marketplace.	BDO supports this recommendation and seeks to participate actively in the listed activities where possible.

Advisory Committee Recommendations	BDO Position
Recommendation V.S.2: Formally encourage the FASB to continue to pursue objectives-based accounting standards. In addition, simplicity and the ease of application should be important considerations when new accounting standards are established.	BDO is ambivalent about objectives-based accounting standards, because they have not been clearly defined and because significant changes in behavior and attitude would be needed to make such standards workable. However, we strongly support making simplicity and ease of application important considerations in adopting new accounting standards as expressed in our comment letter on the FASB's Invitation to Comment, *Principles-Based Approach to U.S. Standard Setting*. The FASB could make standards easier for companies to implement and for investors to understand by (1) minimizing inconsistencies in principles and implementation guidance and (2) tempering conceptual purity with simplicity and ease of application. This should be a primary rather than secondary recommendation.
Recommendation V.S.3: Require the PCAOB to consider minimum annual continuing professional education requirements covering topics specific to SEC matters for firms that wish to practice before the SEC.	We do not support mandated minimum training in this area and believe each firm should decide how much SEC training is appropriate based on the nature and complexity of clients served.
Recommendation V.S.4: Monitor the state of interactions between auditors and their clients in evaluating internal controls over financial reporting and take further action to improve the situation if warranted.	We believe the current improved interaction is generally appropriate and formal SEC action is not warranted.