June 7, 2005

Advisory Committee on Smaller Public Companies
Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549-0609

Attn: Jonathan G. Katz
Committee Management Officer

VIA EMAIL (rule-comments@sec.gov)

Ladies and Gentlemen:

Re: Release Nos. 33-8751; 34-51610; File No. 265-23;
Agenda of the Advisory Committee on Smaller Public Companies

The subject release requests comments on an agenda of issues that the Committee plans to consider in its evaluation of the impact of the securities regulatory system upon smaller public companies. This comment letter is based on the experience of the members of The Society of Corporate Secretaries & Governance Professionals who are implementing the securities laws at public companies, small and large, on a daily basis.

The Society of Corporate Secretaries & Governance Professionals (formerly The American Society of Corporate Secretaries) is a professional association, founded in 1946, with over 4,000 members who serve more than 3,000 issuers. Responsibilities of our members include supporting the work of corporate boards of directors, their audit committees and senior management regarding corporate governance and disclosure. Our members assure issuer compliance with the securities laws and regulations, listing requirements and the accounting rules and have been on the front-line in installing the structural changes necessitated by the Sarbanes-Oxley Act of 2002 and the resulting rules of the Securities and Exchange Commission, the Public Company Accounting Oversight Board and the exchanges.

We are encouraged that the Committee has included a wide range of issues for smaller companies on its agenda, many of which mirror problems seen by our members who are serving smaller companies. We are limiting our comments in this letter to those aspects of the Committee's agenda where we believe the impact of the current regulatory structure on smaller companies is particularly severe:

Definition of "Smaller Public Company" – Committee Agenda §1.2

We are pleased that the Committee will be reviewing these definitions. The $25 million dual limit for use of Regulation S-B results in it being available to only the very smallest public

companies. Given the increased costs of compliance, many commentators have observed that there will likely be very few companies so small going public in the future. This standard has been in place for 13 years without any adjustment for intervening inflation or the increasing cost and complexity of compliance. For this rule to have any meaningful benefit to new and smaller public companies, the threshold needs to be raised to $100 million for both revenue and market capitalization.

Smaller companies have found the application of the $75M "accelerated filer" threshold to SOX §404 compliance particularly onerous. While it was perhaps reasonable at the time Sarbanes-Oxley was passed in 2002 to expect smaller companies over the $75 million threshold to complete their periodic reports more quickly than in the past, putting them on the same schedule as the large companies for the §404 audit was unrealistic. The time and complexity of complying with §404 proved to be far greater than originally anticipated.[1] Smaller companies typically have limited finance and accounting staff and were hard pressed simply to meet the accelerated filing deadline for the periodic reports. They could not complete both the accelerated periodic reports and the §404 audit by the 75th day after the end of the fiscal year. In addition to the shortage of internal resources, as a practical matter, the accounting firms lacked the staff for both financial statement review and the internal controls audit and shifted resources away from the smaller companies to their larger clients. Ultimately, the Securities and Exchange Commission recognized this problem and provided companies between $75 million and $700 million with a one-time extension to the date of the first quarter 10-Q. That extended deadline should be made a permanent part of the rules.

In addition, the Committee should recommend an increase in the $75 million threshold for "accelerated filer" status for periodic reports.

- As noted above, neither the smaller "accelerated filers" nor the accounting firms had the resources to complete the financial statement audit and the §404 work by the 75th day. Accounting firms generally will not sign off on the financial statements until the §404 audit is completed. Practically, smaller companies need more time to complete their Form 10-K. Similar problems recur at the 10-Q filing deadlines.
- "Accelerated filer" status is determined on a single day. Given the volatility of the markets for smaller companies, this is fundamentally unfair. Accelerated filer status should be based on the average market capitalization over an extended period of time.
- The single date approach to determining "accelerated filer" status can leave a company and its auditor with only six months to complete its §404 work. Experience this past year has shown that this is insufficient. Specifically, there are non-accelerated filers which now expect to comply with §404 for 2006, but which could be surprised by a spike in their stock price on a single day at the end of their 2005 fiscal second quarter. Suddenly, they would find that they must fully comply with §404 for 2005, but cannot realistically do so in only six months.

[1] Financial Executives International conducted a series of surveys on the cost of §404 compliance with a sample of companies subject to the internal control audit requirements for 2004. In January 2004, as the process began, the average cost estimate of the FEI companies was $1.93 million. When surveyed again in August 2004, the estimate had risen to $3.14 million. At the completion of the process in April 2005, actual average cost turned out to be $4.36 million.

We believe that $250 million dollars with an inflation adjustment formula is a more realistic standard for determining which companies are "accelerated filers." Companies between $75 million and $250 million simply cannot command sufficient attention of the major auditing firms to regularly meet the new deadlines.

Internal Control – SOX §404 – Committee Agenda §2

The practical reality is that there are many companies above the $75M threshold which are nonetheless viewed as small by the major accounting firms. Because of their small size and the smaller fees that they pay, they lack leverage with the major accounting firms and lack the staff to guide the §404 process. These smaller companies were most likely to have their §404 audits done according to a standard checklist largely undifferentiated for the circumstances of the particular company. Because these companies are smaller even a 10% standard for materiality is a small number. In practice, accountants would divide this number by 2 or 4 (for interim period materiality) which sets a nearly infinitesimal standard of materiality. Thus, everything becomes material and controls must be designed, documented and tested for a huge number of activities. The result was costly and unlikely to have focused on those areas of highest risk and it has to fundamentally change to avoid suffocating the smaller companies.

We appreciate the May 16, 2005 guidance from the SEC and the PCAOB (the "§404 Releases") which tries to move away from this "one-size-fits-all" approach to the §404 audit and suggests a shift toward full year numbers. Realistically, though, because these companies lack leverage with the accounting firms, there is not likely to be much change in the internal control audit processes or reduction in its costs in future years because there are no teeth in the §404 Releases to cause the accounting firms to take a different approach. The Committee needs to develop a methodology to ensure that the §404 Releases are followed by the accounting firms. There are two possible models in current SEC practice, both of which would have utility:

- The SEC's Division of Corporation Finance regularly responds to questions received by telephone from companies and their counsel. The process is informal and provides quick answers to many questions. When questions recur, the Division includes the answers in its telephone interpretations manual, a public document which then affords guidance to other public companies.

- The SEC also has a process for issuing interpretive and no-action letters. While somewhat slower and more formal than the telephone Q&A's, this provides reasonably prompt, carefully reasoned answers to difficult questions.

Both issuers and their accounting firms would benefit if the PCAOB would adopt similar procedures.

In addition, the very substantial cost of §404 compliance has been noted in many places (e.g., the FEI data in footnote 1 above). Thus we would also urge that the Committee recommend the concept of an every-third-year audit of internal controls for the public companies with a market

capitalization under $250 million with limited updating procedures well short of a full audit for the intervening years.

* * *

Thank you for giving our concerns your consideration. We are obviously willing to provide other information which the Committee might find useful or to survey our membership on questions where the Committee might find additional data relevant.

Very truly yours,

SECURITIES LAW COMMITTEE

SOCIETY OF CORPORATE SECRETARIES & GOVERNANCE PROFESSIONALS

By: Karl R. Barnickol
Barbara Blackford
Linda K. Wackwitz
Subcommittee on Smaller Public Companies

cc: Kathleen M. Gibson, Chairman
Susan Ellen Wolf, Chairman-Elect
David W. Smith, President
Pauline A. Candaux, Chair, Securities Law Committee
William J. Mostyn
Society of Corporate Secretaries & Governance Professionals