STATE BOARD OF ADMINISTRATION OF FLORIDA

1801 HERMITAGE BOULEVARD
TALLAHASSEE, FLORIDA 32308
(850) 488-4406

POST OFFICE BOX 13300
32317-3300

JEB BUSH
GOVERNOR
AS CHAIRMAN

TOM GALLAGHER
CHIEF FINANCIAL OFFICER
AS TREASURER

CHARLIE CRIST
ATTORNEY GENERAL
AS SECRETARY

COLEMAN STIPANOVICH
EXECUTIVE DIRECTOR

February 27, 2006

Christopher Cox
Chairman, U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-9303

Re: Section 404 Internal Control Application to Small Companies

Dear Chairman Cox:

The State Board of Administration (SBA) of Florida is writing to express our views on the recommendations of the Small Business Advisory Committee. Managed by the SBA, the Florida Retirement System (FRS) is the fourth largest public pension plan in the United States with approximately 920,000 beneficiaries and retirees, and assets totaling approximately $121 billion.

As you know, a subcommittee of the SEC Small Company Committee has recommended that the SEC and the Public Company Accounting Oversight Board ("PCAOB") either eliminate or significantly weaken the internal control requirements of Section 404 of the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley"). We urge the SEC *not* to accept the recommendation of the SEC Small Company Committee, which would effectively eliminate an important investor protection provision of the Sarbanes-Oxley Act. **As a large passive investor in the U.S. equity markets, we hold ownership stakes in almost every company within the Russell 3000 stock index. The Committee's proposal would exempt almost 1,300—or over 42 percent—of all public companies within this index.** Such a large-scale exemption would have the effect of increasing the cost of capital for those companies the SEC Small Company Committee's recommendation is intended to benefit.

We believe Sarbanes-Oxley is working as evidenced by the high rate of errors detected in financial statements and corrected during 2004 and 2005 as companies implemented Section 404. We respectfully request that you do not adopt the recommendation of the SEC Small Company Committee. If you have any questions, please contact myself or Michael McCauley, Director of Investment Services & Communications, at (850) 413-1252.

Sincerely,

Coleman Stipanovich
Executive Director

cc: Commissioner Paul Atkins
Commissioner Roel Campos
Commissioner Cynthia Glassman
Commissioner Annette Nazareth
Ms. Ann Yerger, Executive Director, Council of Institutional Investors
Ms. Anne Simpson, Executive Director, International Corporate Governance Network
Mr. Kurt Schacht, Executive Director, CFA Centre for Financial Market Integrity

DUKE LAW

Duke University School of Law
Box 90360
Durham, North Carolina 27708

James D. Cox
Brainerd Currie Professor of Law

Telephone (919) 613-7056
Facsimile (919) 668-0995
E-mail: cox@law.duke.edu

March 21, 2006

The Honorable Christopher Cox
Chairman
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549

Re: Response to SEC Release 33-8666 Seeking Comments on the Exposure Draft of the Final Report of the Advisory Committee on Small Business

Dear Chairman Cox:

I, and the many law professors who appear on the attached co-signers' page, join in this letter to express our deep reservations regarding the legal authority of the Securities and Exchange Commission to exempt "micro-cap" registrants from the provisions of section 404 of the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley). The proposed exemption appears in the draft report of the SEC's Advisory Committee on Smaller Public Companies and, pursuant to the definition set forth in the draft, the exemption would remove nearly eighty percent of all U.S. public companies from the requirements of section 404.

As law professors whose research and teaching focus on securities regulations, we have examined the permissible scope of the SEC's authority to promulgate exemptions pursuant to section 36(a) of the Securities Exchange Act of 1934. It is our opinion that section 36(a) of the Securities Exchange Act, or for that matter section 3(a) of Sarbanes-Oxley, does not empower the SEC to exempt issuers from section 404 of Sarbanes-Oxley.

Our conclusion is compelled by the below underscored language of section 36(a):

> [T]he Commission, by rule, regulation, or order, may conditionally or unconditionally exempt any person . . . or any class or classes of persons . . . from any provision or provisions <u>of this title</u> or of any rule or regulation thereunder, to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors.

The expression "of this title" refers to Title I of the Exchange Act. Thus, section 36(a) does not reach other securities law statutes that are within the SEC's jurisdiction, for example the Public

Utility Holding Company Act of 1935, the Investment Company Act of 1940 or the Investment Advisers Act of 1940. Because section 404 of Sarbanes-Oxley is not part of the Exchange Act, it falls outside section 36(a). This conclusion is supported by the committee report accompanying the enactment of the National Securities Markets Improvement Act of 1996 which explains the exemptive authority being provided in both section 28 of the Securities Act and section 36(a) to the Securities Exchange Act as applying only to the provisions of their respective titles.

> "This section adds a new Section 28 to the Securities Act to provide the Commission with the authority, by rule or by regulation, to conditionally or unconditionally exempt any person, security, or transaction, or any class of the same, from any provision or provisions of the Act or any rule or regulation thereunder. . . . The legislation adds a new Section 36 to the Exchange Act to provide the Commission with authority under the Exchange Act similar to that contained in new Section 28 of the Securities Act." *See* H.R. Rep. 104-622, 1996 U.S.C.C.A.N. 3877, at 3900-01

The conclusion that "of this title" refers only to the Securities Exchange Act is further supported by this same expression appearing in section 28 of the Securities Act, section 6(c) of the Investment Company Act, and section 206A of the Investment Advisors Act. Thus, each of these major acts expressly authorize the SEC to establish exemptions but only for "any provision or provisions of this title." When each of these sections are considered, the inescapable conclusion is that none of them provide authority for the SEC to create exemptions other than from the provisions of the particular act whose exemptive authority the SEC has invoked for that exemption.

The Congress, by not imbedding section 404 of Sarbanes-Oxley in the Exchange Act as it did with so many of its other Sarbanes-Oxley provisions, thereby chose to remove section 404 from the SEC's authority to exempt reporting companies from the requirements of section 404. The exclusion of section 404 from the Exchange Act is particularly revealing in view that Exchange Act Section 13(b)(2)(B) mandates that reporting companies "devise and maintain a system of internal accounting controls. . ." If Congress had desired section 404's requirements to be subject to Exchange Act qualification or exemptions that the SEC can adopt pursuant to section 36(a) of the Exchange Act, the natural step for Congress to have taken when enacting section 404 was to cast it as an amendment to Section 13(b)(2). Congress did not do this.

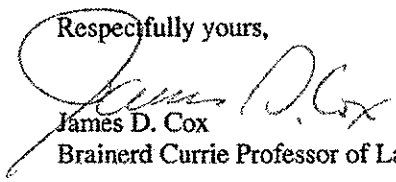
The conclusion that Congress intended all reporting issuers to be subject to section 404, and therefore beyond the power of the SEC to adopt exemptions under section 36(a) of the Exchange Act, is further supported by the language of section 404 which requires that the SEC "prescribe rules requiring each annual report" of a reporting company include assessment by management of internal controls as well as the independent auditor's attestation of management's assessment. Congress certainly envisioned that management's assessment and the auditor's attestation would occur for "each annual report" of reporting companies. Hence, a broad exemption, in addition to being outside the powers the SEC has under section 36(a) of the Exchange Act would also be inconsistent with Congress' clear intent in adopting section 404. Given this conclusion, we also do not believe that section 3(a) of Sarbanes-Oxley can reasonably be read to provide such authority.

The preceding analysis does not mean, however, that the SEC and PCAOB are without authority to tailor section 404 requirements differently for smaller issuers. Sarbanes-Oxley does not authorize the SEC to grant exemptions from its provisions. Instead Sarbanes-Oxley in section 3(a) of Sarbanes-Oxley requires the SEC to promulgate rules and regulations "in furtherance of this Act" that are "in the public interest or for the protection of investors." Specific disclosure

requirements tailored to unique risks and likely regulatory benefits of specific classes of registrants are entirely appropriate and consistent with the rulemaking authority the SEC enjoys under section 3(a) of Sarbanes-Oxley.

We believe a far wiser course for the SEC and the PCAOB is to closely evaluate the reporting risks associated with internal controls of various issuer classes and develop an appropriate framework for section 404 compliance by smaller public companies. In making this evaluation the SEC and the PCAOB should understand that there is abundant empirical evidence that financial reporting violations most frequently involve companies whose market capitalization does not exceed $250 million. This approach is far more consistent with the SEC's overall mission than if it were to grant a sweeping exemption, which we believe is unlawful, of nearly eighty percent of reporting companies from any internal control assessment by its senior management and attestation by the firm's auditors.

Respectfully yours,



James D. Cox
Brainerd Currie Professor of Law

cc: Paul A. Atkins, Commissioner
Roel C. Campos, Commisssioner
Cynthia A. Glassman, Commissioner
Annette L. Nazareth, Commissioner

Co-Signers of Letters

Jeffrey D. Bauman
Professor of Law
Georgetown University Law Center

Rutheford B. Campbell, Jr.
Law Alumni Professor of Law
University of Kentucky College of Law

John C. Coffee, Jr.
Adolf A. Berle Professor of law
Columbia University School of Law

Stuart R. Cohn
Gerald A. Sohn Research Scholar
Levin College of Law, University of Florida

Roger J. Dennis
Professor of Law and Provost
Rutgers, State University of New Jersey, Camden

Jill E. Fisch
Alpin J. Cameron Professor of Law
Fordham Law School

Theresa A. Gabaldon
Professor of Law & Carville Dickinson Benson Research Professor of Law
School of Law, George Washington University

Mitu Gulati
Professor of Law
School of Law, Duke University

Thomas Lee Hazen
Cary C. Boshamer Distinguished Professor
School of Law, University of North Carolina

Robert W. Hillman
Fair Business Practices Chair and Distinguished Professor
School of Law, University of California, Davis

Lyman Johnson
Robert O. Bentley Professor of Law
Washington and Lee Law School

Therese H, Maynard
Professor and Leo T. O'Brien Fellow
Loyola Law School, Los Angeles

Alan Palmiter
Professor of Law
Wake Forest School of Law

Frank Partnoy
Professor of Law
University of San Diego School of Law

Margaret V. Sachs
Robert Cotton Alston Professor of Law
University of Georgia School of Law

Mark A. Sargent
Dean and Professor of Law
Villanova University School of Law

Marc I. Steinberg
Rupert & Lillian Radford Professor of Law
Southern Methodist University Dedman School of Law

Steve Thel
Wormser Professor of Law
Fordham Law School

Randall S. Thomas
John S. Beasley Professor of Law and Business
Vanderbilt University Law School

August 26, 2005

Jonathan G. Katz
Committee Management Officer
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-9303

Re: File Number 265-23

Dear Mr. Katz,

The Council of Institutional Investors, an association of more than 130 public, corporate and union pension funds with combined assets of more than $3 trillion, is pleased to provide input to the SEC Advisory Committee on Smaller Public Companies on the potential impact of the Sarbanes-Oxley Act of 2002 on small businesses.

The Sarbanes-Oxley Act was adopted in the wake of a series of high-profile, shocking scandals and failures of internal controls at a number of U.S. companies. Investor confidence in the U.S. public markets was shattered, and SOX was a necessary and appropriate response to a market crisis.

As a leading voice for long-term, patient capital, the Council believes the Sarbanes-Oxley Act has been vitally important in restoring confidence in and integrity to the financial markets, strengthening investor protections and increasing the accountability of corporate executives and directors of companies of all sizes.

The Council continues to wholeheartedly support the underlying intent of the Sarbanes-Oxley Act, particularly Section 404, for all public companies, large and small. As detailed in the following responses to the questions raised by the Committee's release, the Council strongly believes that the Sarbanes-Oxley Act, including Section 404, should remain intact in its entirety for large and small companies.

Any company, large or small, seeking capital in the U.S. from the investing public must be held to the highest possible standards for accounting integrity, disclosure and transparency. These most basic standards—which are applicable to all publicly traded companies, regardless of size—are why the U.S. capital markets are the envy of the world.

The Council urges the Committee to proceed cautiously with any considerations to "water-down" SOX for small companies. Imposing requirements differentiated by company size—whether pertaining to accounting standards, audit standards, disclosure requirements and/or basic governance requirements—is bad public policy, confusing for the investing public and, in the long run, a bad business decision. Such a shift is a slippery slope that the Council fears could ultimately seriously harm the capital markets and the investing public.

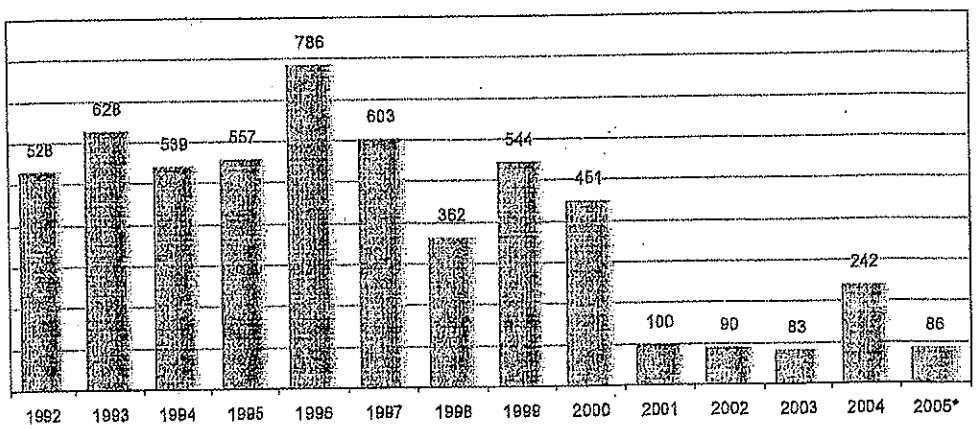
General Impact of Sarbanes-Oxley Act on Smaller Companies

As long-term owners of U.S. public companies, Council members agree that rules and regulations imposed on companies should not be burdensome or unnecessary. The Council does not believe the Sarbanes-Oxley Act falls into these categories.

The Act has not diminished the value of smaller companies or decreased the attractiveness of the U.S. capital markets. Indeed, the Council believes it has enhanced both and played a crucial role in rebuilding confidence in the U.S. markets. That confidence supports the development of small business by making capital available at reasonable costs, which is a benefit that should not be overlooked in this process.

No statistic better addresses the Committee's questions regarding the impact on entrepreneurship and the ability/willingness of companies to meet the demands of being public, than the recent experience of initial public offerings. It is painfully clear that the damage to the capital markets from the fraudulent behavior that became public beginning in 2001 dramatically lowered the access to capital for small companies. It is equally clear that the positive impacts of the reforms such as SOX have helped restore access to capital and increase the ability to issue IPOs. This evidence suggests that the regulatory reforms have not damaged entrepreneurship or changed company thinking about going public. Rather, the reforms have helped reopen the opportunity for small companies to access efficient and fairly priced capital markets.

Chart 1: Total Number of IPOs



Source: Nasdaq, IPO Monitor. * Through June 30, 2005.

Companies have also cited a range of important benefits from the Act, including improved "tone at the top," more involved boards of directors, more robust audits by external auditors, enhanced internal audit resources and performance, higher quality financial statements, fewer restatements of financials and improved operational efficiency. These changes are long-term in nature and difficult to quantify, but the Council believes these benefits over time will far outweigh the costs and will be a positive for all involved in the U.S. capital markets.

William R. Brown, executive VP and CFO of Plum Creek Timber, summarized these benefits in his March 23, 2005, comment letter to the SEC: "As a result of Sarbanes-Oxley and SEC regulations, the intent of Congress to strengthen financial reporting credibility is being achieved. The management of public companies are more aware of their financial reporting responsibilities, and investors have a higher degree of confidence in the documents they produce. In the long-term, that's good for U.S. businesses and investors in the American capital markets."

His statement goes to the heart of the recurring theme of the Advisory committee's questions regarding the impact and effectiveness of the Act and whether smaller companies should be subject to different standards. We agree with Mr. Brown's comment that SOX is in the best long-term interests of the capital markets, and as a result, we oppose efforts to dilute SOX provisions for small or large companies.

Clearly, the implementation costs of portions of SOX have been higher than anticipated. However, first-year implementation problems are not sufficient reason to weaken or eliminate SOX requirements or to adopt significant exemptions based on company size. This action would be premature and would risk serious damage to important reforms that have helped rebuild confidence in the U.S. capital markets. It is simply too early to fully measure SOX's ongoing costs (which are far more important than the implementation costs) and perform a complete cost-benefit analysis. This is not to suggest that investors will tolerate unnecessary costs or gouging by audit firms related to internal control certification.

As discussed earlier, many of the benefits to investors of SOX are long-term and also more intangible than the hard dollar costs of implementation that can be readily identified. The market capitalization of the two major exchanges in the U.S. has increased by about 50 percent or $5.8 trillion since the end of 2002[1]. It is plausible to assume that a major portion of this value can be attributed to improved investor confidence resulting from the major reforms such as SOX. In light of the magnitude of the increased value of the U.S. capital market, the projected ongoing costs appear reasonable. As owners of the companies, investors are the most credible source for a balanced, long-term assessment of the cost/benefit trade-offs of the reforms.

SOX Section 404/Internal Controls

The Council believes Section 404 is a cornerstone of SOX and a necessary adjunct to Section 302, which requires CEOs and CFOs to certify that the annual and quarterly financial reports fairly represent the financial condition and operating results of the companies and to acknowledge that they are establishing and maintaining internal controls.

[1] Source, NYSE and NASDAQ

In this section of the Request for Public Input, the Committee seems interested in feedback on whether small companies are particularly disadvantaged by SOX 404 requirements and whether it is advisable to lower the standards for smaller companies. The Council is concerned that this line of questioning and underlying reasoning leads to consideration of concepts that could be characterized as "404 light" and "GAAP light" for small companies. The Council does not support these concepts and believes that, generally, small companies must be held to the same standards as all other public companies.

Smaller companies already face challenges with access to capital, analyst coverage and even investor interest due at least in part to their perceived increased risks. Setting lower standards for internal controls, regulatory oversight or accounting standards may only make this problem worse.

Internal control problems and scandals are not isolated to larger companies. In fact smaller public companies are more likely to have problems related to internal controls than their larger brethren, so Section 404 is very relevant to small companies. A recent letter from Dana R. Hermanson, professor of accounting at Kennesaw State University, published in *The Wall Street Journal* noted that "it also is critical to recognize that smaller public companies historically have accounted for the vast majority of accounting fraud cases brought by the U.S. Securities and Exchange Commission. In my research on accounting fraud, the typical fraud company was quite small and exhibited signs of an inadequate board and audit committee. In addition, we often found evidence of management override of internal controls, as the vast majority of frauds apparently went to the top of the organization." It would be irrational for the SEC to lower investor protection related to key regulatory reforms such as 404 in precisely the area of the market where the largest number of internal control failures occur.

The Public Accounting Oversight Board's Accounting Statement 2 is designed to be flexible and accommodate differences between large and small companies. It appropriately recognizes that reviews should not be a checklist or a one-size fits all exercise; it appropriately requires auditors to exercise professional judgment; and it appropriately gives auditors the discretion to rely on the work of others. It does not require testing of all controls—only those that might make it probable that the financial statements are materially wrong. As a result, smaller and presumably less complicated companies should incur proportionately lower costs for 404 compliance.

Some of the 404 implementation outlays can be attributed to expected one-time start-up costs associated with complying with <u>any</u> new regulatory standard. The Council believes that most of the criticized costs of compliance with 404 are one-time expenditures caused by years of corporate neglect of internal controls. Complaints over the alleged burdensome and onerous costs of Section 404 are powerful evidence that companies have failed to remain in compliance with the Foreign Corrupt Practices Act of 1977. Former SEC Chairman William Donaldson put it correctly in a March 29, 2005, *Wall Street Journal* article, stating "...Section 404 reporting is too important not to get right. The resources now being devoted to Section 404 will, in the long run, prove to be money well spent."

Some 404-related costs may also be attributed to inappropriate and/or overly conservative interpretations of PCAOB Auditing Standard No. 2. Implementation problems, inefficiencies and overkill are not in the best interests of companies or their investors, and we urge the Securities and Exchange Commission, the Public Company Accounting Oversight Board and COSO (the Committee of Sponsoring Organizations of the Treadway Commission) to continue to provide guidance to address these problems. Special guidance—particularly in the areas of scope of the 404 review and reliance on the work of others—for smaller public companies could be one constructive way to assist efforts to reduce the cost of implementing Section 404 and address concerns that 404 is disproportionately burdening small/mid-sized firms.

Enhanced efficiencies should reduce the costs of compliance going forward. This assertion is supported by expert opinion, studies and even predictions from leaders in the audit industry stating that 404-related costs will decline by as much as 40 percent in subsequent years. Softening the rules for smaller public companies now based mostly on first-year implementation costs would be like estimating all future gas usage of a car based on driving up a steep hill.

Finally, it is important to emphasize that shareowners are not complaining about the costs of Section 404. Since effective internal controls are at the core of reliable financial reporting, shareowners—who ultimately pay 404-related costs—are more than willing to see a company spend money to ensure that the controls are appropriate and effective. Investor support of this important provision of the Sarbanes-Oxley Act is not surprising considering the tremendous losses investors have suffered and continue to suffer as the result of internal control failures and accounting scandals at a host of companies, including small and large firms alike.

Investors are willing to shoulder a reasonable level of additional costs to enjoy section 404's expected longer-term benefits—including stronger internal controls, more reliable financial statements improved confidence in the quality of reported financial statements and improved operational efficiencies. In the long run, small companies that invest in appropriate internal controls are not only more likely to have more reliable financial statements, but also will benefit from better management information structures. It is logical to assume that better information will lead to greater operational efficiency and better long-term performance.

Corporate Governance/Listing Standards

Changes to the NYSE and Nasdaq listing standards requiring a majority of independent directors and all-independent audit, compensation and nomination committees essentially mandated governance standards that have long been observed by many U.S. companies. The changes may have been dramatic to corporate governance laggards, but they were hardly groundbreaking to the many companies already embracing good governance practices.

Most of the changes addressed outdated listing standards that had been in place for decades. The Council urges the Committee to recommend that the exchanges maintain processes to ensure that listing standards are "living documents" updated on a consistent, ongoing basis, rather than sporadically in response to periodic market crises.

Listing standards cannot prevent corporate fraud, deter criminals or ensure ethical behavior. But they can at least ensure that corporate boards have formal structures and processes in place to do the best job possible for investors. As a result, the Council believes the minimal listing standards required by the exchanges should be expected of any company, large or small, accessing the public markets.

There is no evidence that that these basic standards are creating a hardship for smaller companies and certainly no reason to believe that the benefits of maintaining independence on key committees are outweighed by costs. Indeed, isn't an independent board of directors as representatives of shareholders a key tenet of the governance system in the United States? Similar to the points above, the Council believes that lower standards for smaller companies are a disservice to investors and companies alike.

Conclusion

The Council thanks you for your support in facilitating a dialogue on how smaller public companies are impacted by the Sarbanes-Oxley Act and Section 404 in particular. If you have any questions or comments please feel free to contact me, Ted White or Alyssa Ellsworth at (202) 822-0800.

Sincerely,

Ann Yerger
Executive Director
Council of Institutional Investors

March 3, 2006

The Honorable Christopher Cox, Chairman
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Dear Chairman Cox:

We believe that the Sarbanes-Oxley Act of 2002 (SOX) continues to play a critical role in identifying and correcting flawed reporting practices of smaller as well as larger publicly-traded companies. As a consequence, we have become very concerned about the potential impact of, and the process by which, recent recommendations were made to the SEC by its standing Advisory Committee on Smaller Public Companies, or ACSPC,[1] to reduce the reporting requirements of smaller companies by exempting them from some or any compliance with Section 404 of SOX.[2]

AARP was an early and strong supporter of SOX. We believe this farsighted and standard-setting Act is playing a significant role in reestablishing the confidence of investors – individual as well as institutional, American as well as foreign – in our capital markets. Our belief in the basic fairness, transparency and sound governance of our securities markets had been put at serious risk by the accounting scandals of the past few years. Although the market has largely recovered, for many individual investors at or near retirement age the losses were severe, life altering and permanent.[3]

We believe that there are structural weaknesses in the existing advisory process that emanate from the Commission's original charge to the ACSPC in 2004. We believe that these weaknesses have rule-making consequences and need to be corrected. Specifically, and in contrast to the Commission's recent outreach to individual and

---

[1] This advisory panel was established as a standing committee in December, 16, 2004, in response to complaints raised by corporate executives.

[2] Compliance with Section 404 of SOX requires reporting companies to explain their internal controls each year, and their outside auditors to attest to the control's effectiveness. It is a vital element of the reforms introduced by SOX.

[3] See AARP's survey report prepared by S Kathi Brown, "Impact of Stock Market Decline on 50-70 Year Old Investors," published December, 2002.

institutional investors in shaping proposed rules for mutual fund disclosure and the electronic disclosure of proxy materials, an examination of the composition of ACSPC's membership reveals that investors are almost unrepresented. Further, the SEC provided little guidance as to how a smaller company should be defined, leaving the Committee with wide discretion to determine the scope of its own work. It should not be surprising, then, that the recommendations submitted by the ACSPC to the Commission define smaller public companies in more expansive terms – as all firms with market capitalizations up to $750 million.

These "smaller" companies represent 80 percent of all U.S. publicly-traded companies, and 6 percent of U.S. equity market capitalization.[4] We believe that a more proportionate and direct representation of a broader range of investor interests on the ACSPC would likely produce a tighter definition of smaller companies, a more balanced assessment of what Section 404 costs and benefits are to investors in those smaller firms, and a more disciplined examination of the justifications for size-based compliance relief.[5]

We found particularly compelling the joint assessment of the ACSPC Section 404 recommendations by John Biggs, John Bogle, Charles Bowsher, Arthur Levitt and Paul Volcker.[6] In their letter to you dated February 13th, 2006, opposing the adoption of the ACSPC recommendation regarding Section 404, the five cautioned that to exempt 80 percent of all publicly traded-companies simply goes "too far" and runs the risk of undercutting "the effectiveness of Congressional legislation through misguided regulatory action." Less than two weeks later former SEC Chairmen Breeden, Pitt and Donaldson joined Arthur Levitt in a call to refrain from adopting the ACSPC recommendations.[7] We found Arthur Levitt's approach for assisting small businesses and for protecting investors, as outlined in a January 27th Op Ed in the Wall Street

---

[4] Under the ACSPC proposal, firms with market capitalization of under $125 million and revenue of no more than $125 million are characterized as being micro-cap companies, and those with market capitalization below $750 million and revenue of no more than $250 million as small-cap companies. Three tiers of Section 404 compliance would be established: Micro-cap firms would be exempted completely, small-cap companies would not be required to have an independent, out-side auditor test their controls, and larger corporations would – for the time being – be left to fully comply with the provisions of Section 404.

[5] The proxy advisory firm of Glass Lewis reports that smaller public companies restate twice as often as large public companies. Specifically, "companies with annual revenues of less than 500 million had a 2004 restatement rate of 9 %. Companies with revenues of more than $10 billion had a 2004 restatement rate of less than 4%." See: "Restatements – Traversing Shaky Ground," Glass Lewis & Co., June 2, 2005.

[6] These individuals comprised a sub-committee for the audit and accounting section of the 2003 Conference Board Commission on Public Trust and Private Enterprise.

[7] Ex-SEC chiefs warn on foreign policy, disclosure, speaking at the Council of Foreign Relations, Reuters, February 22, 2006.

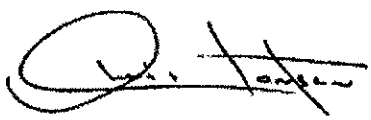
Journal ["A Misguided Exemption," page A8] to be a worthy alternative approach to consider.

The Commission and the Public Company Accounting Oversight Board (PCAOB) will sponsor a roundtable on May 10th to discuss second-year experiences with the reporting and auditing requirements of SOX related to companies internal control over financial reporting. In addition, the release indicates that the Commission seeks written feedback, to be submitted by May 1st, "from registrants, auditors, investors and others on their experiences with complying with the Section 404 requirements." We believe that this request for input could provide beneficial guidance to the SEC and the PCAOB and that the report and recommendations of the ACSPC should not be acted on prior to this broader discussion. We urge the Commission not to adopt the ACSPC recommendations prematurely, and to take full advantage of this opportunity to examine the recommendations in the wider context of potential unanticipated consequences. The roundtable also provides an opportunity to examine other – less onerous – approaches to assist small businesses with their regulatory obligations.

AARP is keenly aware of the role that smaller companies play in our economy and the role they play as important options and opportunities for public investment. To do this in an informed manner, we must ensure to the extent possible that the financial statements that companies prepare to attract investment are reliable representations of the well-being of those companies. We believe that all publicly-traded companies should continue to be governed by Section 404 of SOX. While well-meaning, we believe that exempting small companies from the regime of Section 404 is likely to produce unanticipated effects. We urge the Commission to examine alternative approaches other than these broad exemptions for smaller companies to Section 404.

We look forward to working with the Commission and the PCAOB to resolve these concerns. If you have any questions about the issues being raised above, please do not hesitate to contact Roy Green of our Federal Affairs staff at (202) 434-3800.

Sincerely yours,



Christopher Hansen
Group Executive Officer

Cc: Commissioner Paul Atkins
Commissioner Roel Campos
Commissioner Cynthia Glassman
Commissioner Annette Nazareth

Consumer Federation of America
Consumer Action
Consumers Union
U.S. Public Interest Research Group
Fund Democracy

February 22, 2006

The Honorable Christopher Cox
Chairman
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-9303

The Honorable William Gradison
Acting Chairman
Public Company Accounting Oversight Board
1666 K Street, NW
Washington, DC 20006-2803

Dear Chairman Cox and Acting Chairman Gradison:

As you know, the Advisory Committee on Smaller Public Companies (ACSPC) released recommendations yesterday that would have the effect of exempting roughly 80 percent of all public companies from the requirement that they have their internal controls tested by an independent audit. We are writing on behalf of the nation's leading consumer organizations to urge you not to publish these recommendations for public comment, as originally planned, since they are in direct conflict with the law, would undermine investor confidence, and do not fulfill the Committee's original charge to "conduct its work with a view to protecting investors." Instead, we urge you to disband the advisory group and to start fresh in your search for ways to minimize the cost of regulatory requirements for smaller public companies while retaining their important investor protections.

1. Investors were shut out of the process.

The ACSPC's work is representative of the worst aspects of regulatory policy-making – where business interests are given privileged ability to influence policy that members of the public, in this case investors, are denied.[1] Although the Commission promised in establishing the Committee that its members would be broadly representative of "the varied interests affected

---

[1] This is not an isolated incident. Two advisory groups recently appointed by the NASD at the request of the SEC – the Mutual Fund Task Force and the Breakpoint Task Force – offer similar examples of this lack of investor representation on groups that have enormous influence on the policy-making process. Neither task force included any representation for investors, let alone balanced representation. Even the academic selected to participate on both task forces, while widely respected, often works for industry. Both task forces issued recommendations that largely reinforced industry arguments and either ignored investor concerns or dismissed solutions advocated by investor advocates as unworkable. A more thorough historic review of practices in this area would doubtless show that providing meaningful representation for investor advocates – as the PCAOB has on its Standing Advisory Group – is the exception rather than the rule.

by the range of issues to be considered," it failed to fulfill that promise. No representatives of either the major institutional investors or of retail investors were included on the Committee, though they clearly have an urgent interest in the issues to be addressed.

The only Committee member appointed with a credible claim to advocate on behalf of investors – Kurt Schacht, Executive Director of the CFA Centre for Financial Market Integrity – dissented from the Committee's recommendations. As he said at the time:

> "The subcommittee goal was to reduce the cost burdens but maintain the investor protections associated with Section 404. These need not be mutually exclusive. My concern, and the basis for my dissent, is that the panel's recommendations make them mutually exclusive. We seem to say you can't have meaningful cost reductions unless you eliminate 404, including the investor protections."[2]

It is reasonable to assume that, had the Committee been more balanced in its make-up, it could not have gotten away with offering such one-sided recommendations. Instead, it would have been forced to seek a reasonable compromise that addressed the concerns of all affected parties, including investors.

2. The recommendations are in conflict with the law.

Under the ACSPC's recommendations, companies with a market capitalization of less than $100 million and revenue of no more than $125 million would be exempt completely from Section 404 requirements. In addition, companies with a market capitalization of less than $700 million and revenues of no more than $250 million would not be required to have their internal controls tested by an outside, independent auditor. This is clearly in direct conflict with Section 404 of the Sarbanes-Oxley Act, which requires that managers of all public companies (except investment companies) assess and report annually on the adequacies of their internal controls and that auditors annually report on and attest to the accuracy of management's assessment of those controls. The legislation does not give either the SEC or the PCAOB authority to grant the exemptions proposed by ACSPC.

3. Small companies need improved internal controls.

The prevalence of accounting problems among smaller public companies highlights just how ill-advised the ACSPC's recommendations are. The rate of misstatements and restatements among small companies has been found to be much higher than that of large companies – nearly twice as high, according to one study. Small companies also account for a large majority of accounting fraud cases brought by regulators and shareholders. As Mr. Schacht noted in his dissent, "small public companies need checks and balances over financial reporting."

---

[2] Statement of Kurt Schacht, CFA, Executive Director, CFA Centre for Financial Market Integrity, before the SEC Advisory Committee on Smaller Public Companies, December 14, 2005.

That smaller companies are particularly prone to accounting problems is unlikely to come as a surprise to anyone who observed the recent meeting of the PCAOB Standing Advisory Group devoted to implementation of Section 404.[3] Although it was almost certainly not their intent, the overwhelming message left by a number of the presentations on compliance challenges smaller companies and their auditors face was that internal controls at many smaller companies are in frighteningly poor condition, that managers are ill-equipped to rectify those deficiencies, and that the small audit firms that audit these companies are ill-prepared to conduct the audits of internal controls required by the new law. Given what we know about the strong correlation between weaknesses in internal controls and the likelihood of a financial restatement, it is only logical that a portion of the market that has widespread short-comings in its internal controls would also be beset by accounting problems.

4. The SEC should start from scratch in its search for ways to reduce Section 404 compliance costs for smaller companies while preserving investor protections.

While the greater prevalence of accounting problems among smaller companies is not surprising, what is surprising is that anyone who is aware of these facts would give any credence to a recommendation that the SEC eliminate the requirement for an independent audit of internal controls at the very companies that are most likely to have serious deficiencies in those controls. In fact, these recommendations would likely be dismissed for exactly what they are – the self-interested pleadings of narrow special interests – were it not for the Committee's standing as an official SEC advisory group. That is why it is so important that the Commission repudiate the Committee's recommendations by setting them aside without publishing them for comment.

To further hammer home the message that investor concerns remain a priority at the Commission, we urge the Commission to formally disband the existing Committee and to pledge that, in order to avoid both the perception and the reality of bias in the policy-making process, all future advisory groups of this type will include balanced representation for investor representatives. This would send a strong message that the Commission is committed to ensuring that investors, and not just business groups, have a meaningful ability to help shape the policies that affect them. That alone could help to boost investor confidence in the fairness and integrity of the marketplace.

Although the ACSPC ignored its charge to suggest methods of reducing the costs of Section 404 compliance while preserving its investor protections, others have given the matter serious thought. The recent op-ed piece by former SEC Chairman Arthur Levitt, Jr. offers a particularly practical and thoughtful approach.[4] We urge you to make this, and not the self-interested recommendations of the ACSPC, the starting point for a meaningful policy discussion about how best to balance costs and benefits of Section 404 for smaller companies.

---

[3] Meeting of the PCAOB Standing Advisory Group, June 8-9, 2005.

[4] Arthur Levitt, Jr., "A Misguided Exemption," The Wall Street Journal, January 27, 2006, pg. A8.

5. Conclusion.

Once you start down the road of officially recognizing a second class of public companies subject to weaker corporate governance standards, there will be no end to the requests for new and more expansive exemptions from regulations. The result is likely to be creation of an investing ghetto, where investors venture at their own risk – in this case a ghetto that comprises as much as 80 percent of all public companies. Free market logic suggests that investors will eventually learn to impose a risk premium on companies that fail to adopt adequate corporate governance standards and that the end result will be a higher cost of capital for these companies. That is not in the interest of investors, of the economy as a whole, or even of those who are misguidedly pushing this approach. We urge you not to follow such a path.

Respectfully submitted,

Barbara Roper
Director of Investor Protection
Consumer Federation of America

Ed Mierzwinski
Consumer Program Director
U.S. Public Interest Research Group

Kenneth McEldowney
Executive Director
Consumer Action

Mercer Bullard
Executive Director
Fund Democracy

Ellen Bloom
Assistant Director, Washington, D.C. Office
Consumers Union

cc: Commissioner Paul Atkins
Commissioner Roel Campos
Commissioner Cynthia Glassman
Commissioner Annette Nazareth
PCAOB Board Member Kayla Gillan
PCAOB Board Member Daniel Goelzer
PCAOB Board Member Charles Niemeier

OPERS **Ohio Public Employees Retirement System**
277 East Town Street Columbus, Ohio 43215-4642 1-800-222-PERS (7377) www.opers.org

Sent via email: rule-comments@sec.gov and gradisonw@pcaobus.org

February 17, 2006

Mr. Christopher Cox, Chairman
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Mr. William Gradison, Acting Chairman
Public Company Accounting Oversight Board
1666 K Street, NW
Washington, DC 20006

Re: SEC Advisory Committee on Smaller Public Companies Meeting on February 21, 2006

Dear Chairman Cox and Acting Chairman Gradison:

The Ohio Public Employees Retirement System ("OPERS") is a $68.6 billion fund serving three quarters of a million Ohioans, making the system the 10th largest state pension fund in the U.S. On August 31, 2005, OPERS submitted a detailed comment letter to the Securities and Exchange Commission ("SEC") in response to the questions posed by the SEC Advisory Committee on Smaller Public Companies ("Small Company Committee").

Since that time, a subcommittee of the SEC Small Company Committee has recommended that the SEC and the Public Company Accounting Oversight Board ("PCAOB") either eliminate or significantly weaken the internal control requirements of Section 404 of the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley"). We urge the SEC and the PCAOB *not* to accept the recommendation of the SEC Small Company Committee, which would effectively eliminate an important investor protection provision of Sarbanes-Oxley at approximately 80% of all public companies.

In an effort to restore investor confidence, Congress passed Sarbanes-Oxley in 2002 by a wide margin of 99-0 in the Senate and 432-3 vote in the House. This action was taken in response to the U.S. stock market crash in 2000 and the numerous, large-scale accounting frauds subsequently discovered. Since that time, Sarbanes-Oxley is credited for introducing more transparency into corporate accounting and inspiring trust that helped recent merger and acquisition activity surpass the $1 trillion mark for the first time since 2000 (The National Law Journal, "The Good Times Still Roll," February 6, 2006).

On February 21, 2006, the SEC Small Company Committee will hold a public meeting to formally present its recommendation to the SEC, which if adopted would seriously undermine Sarbanes-Oxley and its investor protection provisions. More specifically, an exemption for approximately 80% of all public companies from Section 404 internal control requirements would seriously diminish investor confidence in the reliability of public company financial statements. Such a large-scale exemption would also have the effect of increasing the cost of capital for those companies the SEC Small Company Committee's recommendation is intended to benefit.

Moreover, research conducted by independent research firm, Glass, Lewis & Co. ("Glass Lewis") found that during 2004 and 2005, many companies that had previously certified to their investors the effectiveness of their internal controls, subsequently disclosed that material weaknesses in their internal controls did in fact exist. In 2005, there were a record number of companies that had to correct their financial statements with approximately half of those restatements by companies who also reported weaknesses in their internal controls. In addition, Glass Lewis found that smaller public companies are riskier as they are more than twice as likely to restate as larger public companies. A report of the Committee of Sponsoring Organizations in 1999 also found that the occurrence of fraud was also higher at smaller companies.

We believe the benefits of Sarbanes-Oxley continue to outweigh the costs associated with implementing its investor protection provisions. Sarbanes-Oxley is working as Congress intended as evidenced by the high rate of errors detected in financial statements and corrected during 2004 and 2005 as companies implemented Section 404. The SEC and PCAOB should not weaken these investor protection provisions, particularly for a higher risk category of public companies.

We support the approach outlined by former SEC Chair Arthur Levitt in his January 27, 2006 Wall Street Journal opinion editorial entitled "A Misguided Exemption." This approach is reasonable and can be implemented through additional SEC and PCAOB staff guidance without revising existing auditing standards. It is a sound approach based on both auditors and management applying "common sense" guidance, including the guidance already issued by the SEC and PCAOB staff in 2005. It appears that such guidance, and any additional implementation guidance, would continue to have a positive effect in reducing Section 404 implementation costs while still preserving a reasonable means of testing the effectiveness of internal controls to protect investors. We respectfully request that you *not* adopt the recommendation of the SEC Small Company Committee.

Thank you for providing us with this opportunity to comment. Should you need any additional information, please contact Cynthia Richson, OPERS Corporate Governance Officer, at 614.222.0398.

Sincerely,

Laurie Fiori Hacking
Executive Director

February 13, 2006

Mr. Christopher Cox, Chairman
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Mr. William Gradison, Acting Chairman
Public Company Accounting Oversight Board
1666 K Street, NW
Washington, DC 20006

Dear Chairman Cox and Acting Chairman Gradison:

We strongly recommend the Securities and Exchange Commission (SEC) and the Public Company Accounting Oversight Board (PCAOB) not accept the recommendation of the Small Business Advisory Committee that would remove an estimated 80% of all public companies from the requirements of Section 404 of the Sarbanes-Oxley Act of 2002 (Sarbanes Oxley).

Such a recommendation simply goes too far. When new accounting and corporate fraud scandals develop, as they surely will, people will ask who was responsible for a policy decision resulting in such sweeping exemptions. It would rank with the accounting profession's 3% rule on SPE's and the famous Garn/St. Germain legislation in the early 1980's that led to the failure of hundreds of savings and loan (S&L) institutions when restrictions on their lending activities were suddenly swept away. The S&L industry recommended that legislation to solve a problem, but the disaster that followed in a few years cost the American taxpayers about $250 billion. In passing the Sarbanes Oxley legislation, the Congress adopted a reasonable approach to achieve real reform, not just the appearance of reform. It would be unfortunate now if the SEC and PCAOB undercut the effectiveness of Congressional legislation through misguided regulatory action.

A much more reasonable approach to assist the small public companies and to protect investors was outlined by the former Chairman of the SEC, Arthur Levitt's recent Op-Ed piece in the Wall Street Journal which is enclosed as an attachment to this letter.

The five signatures below are the individuals that comprised a sub-committee for the audit and accounting section of the 2003 Conference Board Commission on Public Trust and Private Enterprise report that was convened to address the circumstances which led to the 2002 corporate scandals and subsequent decline of confidence in American capital markets.

Sincerely,

John H. Biggs Former Chairman and CEO of TIAA-CREF	John C. Bogle Former Chairman of Vanguard Group, Inc.	Charles A. Bowsher Former Comptroller General of The United States of America	Arthur Levitt, Jr. Former Chairman of the SEC	Paul Volcker Former Chairman of the Board of Governors of The Federal Reserve System

Attachment

WSJ.com THE WALL STREET JOURNAL. ONLINE

A Misguided Exemption

By ARTHUR LEVITT, JR
January 27, 2006; Page A8

I began my Wall Street career more than 40 years ago sharing an 800-square-foot office with 10 other brokers. Since then, I have been involved in a number of small businesses -- from newspapers to high-tech companies -- and no matter the industry, the focus of every one of these has been growth. Unlike in a large company, stagnancy in a small business can lead not only to a diminished paycheck, but to extinction.

Small businesses employ a majority of private-sector workers and create 60% to 80% of net new jobs annually. This economic might, combined with the sector's political muscle, has kept policymakers vigilant in spotting impediments to small-business growth. Currently, the focus of many small-business advocates is the perceived burden placed on them by Section 404 of the Sarbanes-Oxley Act, which requires companies to assess and report the status of their internal controls. They worry that the cost of compliance is onerous, inhibiting their ability to access capital markets and grow.

In response, the Securities and Exchange Commission's advisory committee on smaller public companies has recommended that microcap and smaller public companies be exempted from the main parts of 404. Under their plan, public companies with a market cap of less than $100 million and revenue of no more than $125 million would be exempt completely from 404 requirements. Slightly larger companies -- those with a market cap of less than $700 million and revenues of no more than $250 million -- would not be required to have an independent, outside auditor test their internal controls.

While the advisory committee is well-intentioned, I fear that these proposed changes will harm, not help, small companies. I can appreciate the political pressure the SEC may be facing; the small-business lobby is almost unrivaled in the fear it instills in policymakers. But political pressure often leads people down the path of least resistance and toward superficial, even counterproductive, fixes. Indeed, if these recommendations were implemented, they would make it more difficult for smaller companies to attract capital needed for growth and undermine confidence in the markets. Instead of searching for exemptions to the rule, we need to step back and help small businesses improve financial controls, attract capital, and strengthen the very markets critical to their ability to flourish.

Thankfully, the market downturn of the immediate post-Enron years is behind us. As seen in the significant increases in IPO and mergers-and-acquisitions activity, there is a renewed vigor in our markets. Driving this has been a resurgence in investor confidence, fueled by the implementation of SOX reforms, including those enumerated in Section 404.

Exempting smaller and microcap companies -- 80% of all public companies -- from the requirements of 404 would undermine this renewed trust in our markets. Consider that these companies are the ones most likely to have internal control problems, and least likely to have analysts, institutional investors and the media watching them. In the five years before 2004, nearly three-quarters of financial restatements were reported by companies with annual revenues of less than $500 million. Already, many institutional investors do not invest in smaller companies because of risks associated with them. If one increases that risk by setting a lower bar for internal controls, it will burden these companies with a risk premium that will drive up their cost of capital. Creating a different standard would relegate small businesses to a "second-class" in the marketplace, and hinder their growth as much as any onerous regulation.

The debate until now has centered on who should be exempted, not on how to ensure that companies have the internal controls needed to prepare reliable financial statements. This focus is unproductive since it is clear from a reading of SOX that Congress wanted all public companies to assess internal controls and have an outside auditor test them. Instead of defying Congress and provoking costly litigation, we need to work within the law to find ways to make compliance easier and less expensive for small businesses.

To start, we need to recognize the difficulties in compliance that turned up in the first year of 404-compliance. Many companies were ill-prepared for an audit: Their internal controls either were not in place or not documented, and many lacked accounting and finance staff able to do this work. At the same time, many of the audit firms lacked the tools, expertise and training to assess the internal controls of smaller companies. They were using audit tools created for large multinationals, the financial equivalent of using an MRI to diagnose a cold. Many audit firms failed to integrate their findings from the internal control testing into the financial statement, as required by SOX, and as a result performed two separate audits. As the SEC and Public Company Accounting Oversight Board have noted, auditing firms needlessly repeated management and internal auditors' tests of internal controls, creating more work for themselves and higher bills for small businesses.

• Moving forward, we need, first, to redefine what constitutes a small business. The current debate has been skewed by a definition so broad as to include a vast majority of the market. A company's complexity is not dependent on its market cap. Some very large companies -- such as many of the airlines -- have market caps that pale in comparison to their complexity. Conversely, there are tech companies that have few employees and office sites, but huge market caps based on expected revenues. The current definition of a small business issuer should be updated to include companies with up to $50 million in revenues and fewer than 250 employees. If they have been able to attract more than $100 million in public capital, they should be ineligible for small business filer status.

• Second, the SEC and PCAOB should urge accounting and financial executive trade groups, as well as the software industry, to work together to develop reasonably priced tools tailored specifically for small companies and the small accounting firms who mainly audit them. These should permit a company to document internal controls so that auditors do not need to duplicate the documentation, and include control testing programs

integrated with that documentation and the work performed on the year-end balance sheet and income statement. The tools must be made available before 2007 when small companies are required to comply with 404.

• Third, the SEC must reconfigure itself to provide more readily accessible assistance to small companies. In 1997, I reorganized the SEC so that the enforcement function was centralized in Washington. An unintended consequences of this was to close off a local avenue for accounting assistance for small businesses. Many small companies do not have good technical accountants and cannot afford them. If the SEC placed those that review small business filings closer to the businesses and supplemented its staff with a small group of accountants that can answer questions small companies might have, it would help avoid restatements and reduce costs.

• Fourth, while the SEC and PCAOB have issued some helpful guidance on how to streamline the auditing of internal controls, they should go further in easing requirements while stepping up enforcement. If a company has documented monitoring controls, and the monitoring process has not discovered any problems except for isolated cases, then no further internal examination by the company should be required. Re-examining controls when monitoring controls are working has layered on unnecessary work that has driven up costs for businesses. Companies should be given credit for doing the right thing, and not have to pay to recheck what they are doing right. However, if the auditor finds that monitoring controls have not been working and financials need to be restated, then a company should expect a swift SEC enforcement action.

These steps should help small companies update internal controls cost-effectively, without gutting the financial reporting regime that undergirds our capital markets. In light of the importance of small businesses to the economy, the last thing we need is regulation that stifles their entrepreneurship -- or deregulation that makes it more difficult for them to succeed in the public capital markets.

Mr. Levitt, former chairman of the SEC, was the chairman of the first White House Conference on Small Business.