



December 8, 2009

**EXECUTIVE DIRECTOR**

Cynthia M. Fornelli

**GOVERNING BOARD**

Chairman  
James S. Turley, Chairman and CEO  
Ernst & Young LLP

Vice Chair  
Michele J. Hooper, President and CEO  
Directors' Council

Vice Chair  
Barry C. Melancon, President and CEO  
AICPA

Charles M. Allen, CEO  
Crowe Horwath LLP

Harvey J. Goldschmid, Dwight Professor of Law  
Columbia University

Robert E. Moritz, Chairman and Senior Partner  
PricewaterhouseCoopers LLP

Edward Nusbaum, CEO and Executive Partner  
Grant Thornton LLP

Lynn S. Paine, John G. McLean Professor  
Harvard Business School

Barry Salzberg, CEO  
Deloitte LLP

Dave Scudder, Managing Partner  
McGladrey & Pullen, LLP

John B. Veihmeyer, CEO  
KPMG LLP

Jack Weisbaum, CEO  
BDO Seidman, LLP

The Honorable Barney Frank  
Chairman, House Committee on  
Financial Services  
United States House of Representatives  
2129 Rayburn House Office Building  
Washington, D.C. 20515

The Honorable John P. Sarbanes  
United States House of Representatives  
426 Cannon House Office Building  
Washington, D.C. 20515

The Honorable Paul E. Kanjorski  
Chairman, Subcommittee on Capital Markets,  
Insurance, and Government Sponsored  
Enterprises  
United States House of Representatives  
2129 Rayburn House Office Building  
Washington, D.C. 20515

The Honorable Steve Cohen  
United States House of Representatives  
1005 Longworth House Office Building  
Washington, D.C. 20515

Dear Chairman Frank, Subcommittee Chairman Kanjorski, Representative Sarbanes and Representative Cohen:

As representatives of the auditing profession, the Center for Audit Quality (CAQ)<sup>1</sup> commends you for your continued support of Section 404(b) of the Sarbanes-Oxley Act (SOX), which requires an independent audit of a company's assessment of its internal controls over financial reporting (ICFR). We understand you are contemplating an amendment that would preserve the potential application of this important investor protection to public companies of all sizes. We support such efforts.

Internal control plays an important role in protecting a business's resources and can help reduce the risk of fraud. Just as with the audit of financial statements, the independent auditor's evaluation of a company's internal control over financial reporting provides a valuable independent perspective on the effectiveness of a public company's internal controls.

Without such a requirement, there may be little independent scrutiny of financial reporting safeguards at an estimated 6,000 small companies. As one recent news report concluded, "There'll be more flaws in those safeguards that won't be found and fixed. That, in turn, means it's more likely that errors and fraud will make their way onto small companies' financial statements, and that they won't be found until it's too late to avoid hurting investors."<sup>2</sup>

<sup>1</sup> The CAQ is an autonomous public policy organization dedicated to enhancing investor confidence and public trust in the global capital markets. We foster high quality performance by public company auditors, convene and collaborate with other stakeholders to advance the discussion of critical issues requiring action and intervention, and advocates policies and standards that promote public company auditors' objectivity, effectiveness and responsiveness to dynamic market conditions. Based in Washington, D.C., the CAQ is affiliated with the American Institute of Certified Public Accountants. This letter represents the observations of the CAQ, but not necessarily the views of any specific firm, individual or CAQ Governing Board member.

<sup>2</sup> "IN THE MONEY: Small Co's Win Sarbanes-Oxley Help; Investors Lose," Dow Jones News Service, Nov. 9.

Reporting under Section 404 provides investors with meaningful information regarding a company's internal control over financial reporting (ICFR). We believe that the required independent audit of management's assessment of the effectiveness of ICFR, as required by SOX Section 404(b), has been integral to the achievement of the intended objectives of ICFR reporting under SOX Section 404.

While we recognize that there is a cost to conducting an audit of a company's ICFR, as we have previously communicated to you, we believe that the PCAOB and SEC, as well as other organizations such as Committee of Sponsoring Organizations of the Treadway Commission (COSO) and the CAQ, have expended considerable efforts to improve both the effectiveness and efficiency of ICFR reporting, which has had the intended effect of rationalizing the effort required to conduct Section 404 assessments. In addition, it is also important to note that investors and other users of financial information have consistently expressed the view that the independent audit of management's assessment of ICFR provides significant benefits to them when making their investment decisions. Some of the feedback received includes the following:<sup>3</sup>

- The independent audit of management's assessment increases investors' confidence in the quality and reliability of a company's financial reports and ICFR assessment.
- The independent auditor's expertise can provide management with an additional perspective on the quality of a public company's ICFR, which can facilitate improvements in internal control that have a positive impact on the quality of a company's financial reporting.
- Section 404 reporting, including the independent audit, provides benefits that are valuable regardless of a public company's size and represents an appropriate use of a public company's resources given the significant role a strong internal control structure has in providing reliable financial reports for investors.

Investor confidence in public companies' financial reports is imperative to the successful operation of our capital markets. As such, it only makes sense to extend the benefits of Section 404(b) to investors in smaller public companies. That is especially meaningful in view of the fact small companies are more likely to issue earnings restatements. This is buttressed by Audit Analytics' November study suggesting that companies that have not yet had auditors review their internal control reports have a restatement rate that is 46 percent higher than larger companies, despite claiming they have effective controls.

Reforms under SOX have contributed greatly to restoring investor confidence that was so seriously shaken by corporate scandals earlier this decade. We applaud your commitment in the wake of the most recent economic crisis to sustaining investor confidence in the capital markets through your efforts to protect these important reforms.

Sincerely,



Cynthia M. Fornelli  
Executive Director  
Center for Audit Quality

---

<sup>3</sup> These views were expressed as part of the SEC's Study of Section 404 (See SEC, Office of Economic Analysis, *Study of the Sarbanes-Oxley Act of 2002 Section 404 Internal Control Over Financial Reporting Requirements* (September 2009), available at [http://www.sec.gov/news/studies/2009/sox-404\\_study.pdf](http://www.sec.gov/news/studies/2009/sox-404_study.pdf)), at roundtable discussions and comment letters received as part of the SEC and PCAOB projects related to ICFR (See, for example, transcripts from May 10, 2006 and April 13, 2005 SEC and PCAOB roundtables, available at <http://www.sec.gov/spotlight/soxcomp/soxcomp-transcript.txt> and <http://www.sec.gov/spotlight/soxcomp/soxcomp-trans.txt>, respectively) and comments received by SEC and PCAOB related to AS No. 5 (at <http://www.sec.gov/comments/pcaob-2007-02/pcaob200702.shtml> and [http://www.pcaobus.org/Rules/Docket\\_021/index.aspx](http://www.pcaobus.org/Rules/Docket_021/index.aspx), respectively).

cc: Mary L. Schapiro, Chairman, Securities and Exchange Commission  
Luis Aguilar, Commissioner, Securities and Exchange Commission  
Kathleen L. Casey, Commissioner, Securities and Exchange Commission  
Troy Paredes, Commissioner, Securities and Exchange Commission  
Elisse B. Walter, Commissioner, Securities and Exchange Commission  
Daniel L. Goelzer, Acting Chairman, Public Company Accounting Oversight Board  
Willis D. Gradison, Member, Public Company Accounting Oversight Board  
Steven B. Harris, Member, Public Company Accounting Oversight Board  
Charles D. Niemeier, Member, Public Company Accounting Oversight Board

