



May 20, 2010

The Honorable Harry Reid  
Majority Leader  
United States Senate  
S-221, U.S. Capitol  
Washington, D.C. 20510

The Honorable Mitch McConnell  
Minority Leader  
United States Senate  
S-231, U.S. Capitol  
Washington, D.C. 20510

The Honorable Christopher J. Dodd  
Chairman, Senate Committee on  
Banking, Housing and Urban Affairs  
534 Dirksen Senate Office Building  
Washington, D.C. 20510

The Honorable Richard C. Shelby  
Ranking Member, Senate Committee on  
Banking, Housing and Urban Affairs  
534 Dirksen Senate Office Building  
Washington, D.C. 20510

Dear Majority Leader Reid, Minority Leader McConnell, Chairman Dodd and Ranking Member Shelby:

We again urge you to resist efforts to weaken protections for investors in the Sarbanes-Oxley Act of 2002 (SOX). Specifically, we are writing in opposition to the exemption of smaller public companies from compliance with Section 404(b) of the Act, as proposed by Sen. Vitter (SA 3764) and Sen. Hutchison (SA 3785).

As you know, Section 404(b) requires an independent audit of a public company's assessment of its internal controls. Senator Vitter's amendment would permanently waive compliance for non-accelerated filers (companies with market capitalization of less than \$75 million), resulting in little independent scrutiny of financial reporting safeguards at half of all listed companies nationwide.

Senator Hutchison's amendment would go even further, by extending the exemption to companies with market capitalization of \$150 million, thereby rolling back existing internal controls requirements for companies that are already in compliance.

We also note that both amendments call for a study to determine how the Securities and Exchange Commission (SEC) could reduce the burden of complying with Section 404(b) for companies with market capitalization of up to \$250 million (Vitter amendment) or up \$700 million (Hutchison amendment), "while maintaining investor protections for such companies." However, the SEC has already conducted such a study, mandated by Congress, which found that Section 404 provides benefits that are valuable regardless of a public company's size. Reporting requirement reforms, including the Public Company Accounting Oversight Board's adoption of Audit Standard No. 5 and the SEC's management guidance, are reflective of the real-world lessons learned since enactment of SOX. The result has been a decline in compliance costs of approximately 30 percent.<sup>1</sup>

---

<sup>1</sup> 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).

We dispute the suggestion that Section 404(b) compliance can be eased without placing investors in smaller public companies at a distinct disadvantage to investors in larger public companies. To wit, a forthcoming research study by The Committee of Sponsoring Organizations of the Treadway Commission determined that between 1998 and 2007 the median assets of companies experiencing fraudulent events rose to approximately \$100 million.<sup>2</sup> This should give pause to anyone of the opinion that smaller public companies are immune to the fraudulent financial activity Section 404(b) seeks to deter.

Investor confidence in financial reports of public companies – large and small – is of tremendous importance to the strength and stability of our capital markets. We hope you will not allow that confidence to be eroded by the adoption of either amendment.

Sincerely,



Cindy Fornelli  
Executive Director  
Center for Audit Quality



Jeff Mahoney  
General Counsel  
Council of Institutional Investors

cc: Members of the United States Senate

---

<sup>2</sup> Fraudulent Financial Reporting: 1998-2007, An Analysis of U.S. Public Companies, Commissioned by the Committee of Sponsoring Organizations of the Treadway Commission, May 2010.