

**SEC ADVISORY COMMITTEE ON
SMALLER PUBLIC COMPANIES**

Washington, DC 20549-3628

August 18, 2005

The Honorable Christopher Cox
Chairman
U. S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1070

Dear Chairman Cox:


On behalf of the Commission's Advisory Committee on Smaller Public Companies, we are pleased to submit the enclosed two resolutions containing recommendations to the Commission. The Committee adopted both recommendations unanimously at a public meeting held on August 10, 2005.

As you know, the Commission organized the Advisory Committee in March 2005 to assess the current regulatory system for smaller companies under the securities laws of the United States and to make recommendations for changes. The enclosed two recommendations are the first proposals of what we hope will be a number of beneficial suggestions to the Commission in fulfillment of this mandate.

The Committee is submitting these recommendations now, rather than waiting to include them in our final report due in April 2006, for several reasons. Among them, with respect to the Sarbanes-Oxley Section 404 recommendation, the Committee believes that prompt Commission action is advisable to prevent a significant misuse of funds by smaller public companies in the immediate future. In addition, the advisability of implementing these recommendations seemed apparent to the Committee; further study did not seem justified.

We and the other members of the Committee are prepared to provide any additional assistance the Commission or its staff may request in this regard.

Respectfully submitted on behalf of the Committee,



Herbert S. Wander
Committee Co-Chair



James C. Thyen
Committee Co-Chair

Members of the Committee:

Patrick C. Barry
Steven E. Bochner

Richard D. Brounstein
C.R. "Rusty" Cloutier

James A. "Drew" Connolly III
E. David Coolidge, III
Alex Davern
Joseph "Leroy" Dennis
Janet Dolan
Richard M. Jaffee
Mark Jensen
Deborah D. Lambert
Richard M. Leisner
Robert E. Robotti
Scott R. Royster

Pastora San Juan Cafferty
Kurt Schacht
Ted Schlein
James C. Thyen
John B. Veihmeyer
Herbert S. Wander

Official Observers:
George J. Batavick
Daniel L. Goelzer
Jack E. Herstein

Enclosures (2)

cc: Commissioner Cynthia A. Glassman
Commissioner Paul S. Atkins
Commissioner Roel Campos
Commissioner Annette L. Nazareth
Alan L. Beller
Jonathan G. Katz
Gerald J. Laporte

Securities and Exchange Commission
Advisory Committee on
Smaller Public Companies

Resolution Regarding Section 404 Compliance Dates
For Non-Accelerated Filing Companies

Adopted at the
Advisory Committee Meeting
August 10, 2005

WHEREAS, the Securities and Exchange Commission ("Commission") has twice extended the dates for certain registrants to comply with the filing requirements under Section 404 of the Sarbanes-Oxley Act of 2002 and certain other rules of the Commission under the Securities Exchange Act of 1934 ("Exchange Act") (Release Nos. 33-8392, Feb. 24, 2004 and 33-8545, Mar. 2, 2005); and

WHEREAS, based on oral and written presentations made to the Advisory Committee, the written and oral testimony given to the Commission at its April 2005 Roundtable dealing with Section 404 and the experiences of the members of the Advisory Committee;

The Advisory Committee hereby recommends that the Commission further extend these compliance dates, as follows:

- A. A company that is a non-accelerated filer should begin to comply with the management report on internal control over financial reporting requirement and the related registered public accounting firm report requirement in Items 308(a) and (b) of Regulations S-K and S-B for its first fiscal year ending on or after July 15, 2007, instead of its first fiscal year ending on or after July 15, 2006.
- B. If necessary, corresponding extensions should also be made to the application of Exchange Act Rules 13a-14(a) and 15d-14(a) as well as to the amended portion of the introductory language in paragraph 4 of the certification required by Exchange Act Rules 13a-14(a) and 15d-14(a).

* * * *

The Advisory Committee is of the opinion that there is overall consensus and widely-held support for this recommendation. There are manifold reasons for delay, among them:

- * The costs of implementing Section 404 have been far more expensive than originally forecasted and these costs are disproportionately larger for smaller companies. In addition to the actual costs, because of the newness and

complexity of the rules, companies have had to expend considerable management time and effort to establish and attest to the effectiveness of their internal control over their financial reporting.

* The process of reporting on internal control over financial reporting has been far more complex and difficult to implement than originally thought and is still evolving.

* Efforts are underway to improve the process, especially for smaller public companies, including the Commission's and PCAOB's May 2005 guidance and the anticipated guidance to be published by COSO, but the Advisory Committee does not believe these efforts will bear fruit for some considerable time. Therefore, non-accelerated filers should have an opportunity to delay filing until these efforts progress further.

* The Advisory Committee believes the Commission should take action to implement this recommendation as soon as possible. Otherwise, non-accelerated filers, who are currently in the process of implementing their internal control over financial reporting, will incur heavy costs and base their implementation on rules that the Advisory Committee will most likely recommend be changed.

Securities and Exchange Commission
Advisory Committee on
Smaller Public Companies

Resolution Regarding Acceleration of Filing Dates
for Annual and Quarterly Reports of Smaller Public Companies

Adopted at the
Advisory Committee Meeting
August 10, 2005

WHEREAS, the Securities and Exchange Commission (“Commission”) has adopted rules accelerating the required filing of annual and quarterly reports under the Securities Act of 1934 (“1934 Act”) by most public companies that have a public float of at least \$75 million (Release No. 34-46464, Sept. 5, 2003, *as corrected*, Release No. 34-46464A, Apr. 8, 2003);

WHEREAS, these accelerated filing requirements are being phased in over a number of years, so that annual report deadlines would move gradually from the original 90 days to 60 days and quarterly report deadlines would move gradually from the original 45 days to 35 days, with the current requirements 75 days for annual reports and 40 days for quarterly reports; and

WHEREAS, oral and written presentations made to this Advisory Committee and the experiences of its members indicate that smaller public companies would be seriously challenged by further phase-in of these accelerated filing requirements because of recent significant increases in other securities regulatory burdens and because of the lack of capacity in the securities regulatory infrastructure, including the capacity of internal compliance personnel and external professional advisors to smaller public companies, and if the currently required phase-ins became effective, they will likely lead to increased late filings and/or less accurate filings; and

WHEREAS, oral and written presentations made to this Advisory Committee and the experiences of its members indicate that, because of characteristics of the marketplace for the securities of smaller public companies, the direct and indirect costs of further acceleration of required annual and quarterly report filings for these companies would exceed the benefits to investors and the public;

The Advisory Committee hereby recommends to the Commission that:

A. Smaller public companies not be subject to any further acceleration of due dates for annual and quarterly reports under the 1934 Act; and

B. In implementing the foregoing recommendation, the Commission should look for guidance in defining the term “smaller public company” to the definition of that term adopted by the Advisory Committee, by a vote of 14 to 0 with one abstention, as an internal working definition to provide an umbrella definition under which the Advisory

Committee's four subcommittees can bring forth recommendations that are meaningful for their specific purposes.

The Advisory Committee directs that copies of the documents entitled "Six Determinants of a Smaller Public Company" and "Definition of Smaller Public Company," which were made available to the members of the Advisory Committee before it adopted its definition of the term "smaller public company," be attached to this resolution and made a part hereof, and suggests that the Commission consult these documents in implementing Recommendation B above.

Attachments

Securities and Exchange Commission
Advisory Committee on
Smaller Public Companies

August 10, 2005

Six Determinants of a Smaller Public Company

The definition of a smaller public company should be determined by:

1. The total market capitalization of the company
 - This acknowledges the relative risk to investors and the capital markets as it is currently used by professional investors.
 - The SEC has used market capitalization for other purposes (e.g., accelerated filer status in securities reform proposals for Well-Known Seasoned Issuers).
 - Using total market capitalization rather than capitalization of “public float” avoids the problem in deciding which holdings are public float shares and which are not.
 - Market capitalization information is available from a variety of well-recognized sources (e.g., Russell, Standard and Poors) and will not have to be developed separately by the SEC.
 - Total market capitalization is the best measurement of risk and exposure to investors and, therefore, the best way to measure potential loss to protect investors from such losses (e.g., 100 bankruptcies of a company with \$10 million total market capitalization would be required to equal the potential loss of the bankruptcy of a company with \$1 billion of market capitalization).
2. A measurement metric that facilitates scaling of regulation
 - This allows for a long-term solution.
 - This avoids the problem created by using a dollar amount definition, which would have to be rewritten from time to time.
 - This allows for an elastic measurement, which will move up and down, depending upon stock price and the levels of the market.
 - This will work in both inflationary and deflationary economic environments.
 - This allows for the definition of smaller public company to be applied as appropriate with individual context and perspective of the different regulatory areas (e.g., capital formation, accounting standards, governance and disclosure, and internal control/404).
 - Will apply uniformly to all companies regardless of their cost structure or their capital structure.
3. A measurement metric that is self-calibrating
 - This allows the cut-off point to automatically readjust without the need for further action.

- This allows for self determination.
 - This will enable decisions based on objective, easily understood metrics and avoid subjective opinion.
 - Provides certainty as to the rules for the companies required to comply.
 - This avoids the problem created by using a dollar amount definition, which would have to be rewritten from time to time.
4. A standardized measurement and methodology for computing market capitalization
- This provides clarity to the rules.
 - This removes the risk of interpretation leading to litigation.
 - This allows for self determination.
 - This will enable companies to determine capital formation alternatives available by providing constancy in a measurement and methodology.
 - This will enable decisions based on objective, easily understood metrics and avoid subjective opinion.
5. A date for determining total market capitalization
- This provides clarity to the rules.
 - This allows for self determination.
 - A company should know on the first day of its fiscal year whether it is a smaller company or a larger company.
 - One date will apply uniformly to all companies, regardless of their fiscal years or other company differences.
6. Clear and firm transition rules (small to large and large to small)
- This will provides clarity for investors and companies.
 - This allows for self determination.
 - Allows companies to return to the smaller category when appropriate.
 - This will reduce regulatory burden of providing complex transition rules or interpretations.
 - This allows companies to plan for transitions in a suitable time to achieve compliance with new regulations.

Securities and Exchange Commission
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Definition of Smaller Public Company

Advisory Committee overarching principles:

- Further Commission's investor protection mandate
- Seek cost choice/benefit inputs
- Keep it simple
- Maintain culture of entrepreneurship
- Capital formation should be encouraged

Size subcommittee end goal:

- To give the Advisory Committee a recommendation on defining "smaller public company"

The definition of a smaller public company should be determined by:

1. The total market capitalization of the company
2. A measurement metric that facilitates scaling of regulation
3. A measurement metric that is self-calibrating
4. A standardized measurement and methodology for computing market capitalization
5. A date for determining total market capitalization
6. Clear and firm transition rules (small to large and large to small)

The recommendation is that a company ranking in the bottom 6% of total U.S. public market capitalization, as defined by the SEC, when the capitalization of all public companies is combined, would qualify as a smaller public company. A company ranking in the bottom 1% of total U.S. public market capitalization would qualify as a microcap company.

- Approximately 80% of all U.S. public companies provide only approximately 6.4% of all U.S. public market capitalization. These are smaller public companies. (These companies had a market capitalization of less than approximately \$700 million in March 2005.)
- Approximately 50% of all U.S. public companies provide only approximately 1% of all U.S. public market capitalization. These are microcap companies. (These companies had a market capitalization of less than approximately \$100 million in March 2005.)
- Approximately 20% of all U.S. public companies provide approximately 93.6% of all U.S. public market capitalization. These are large public companies. (These companies had a market capitalization of more than approximately \$700 million in March 2005.)