

April 22, 2010

The Honorable Christopher Dodd  
Chairman

The Honorable Richard Shelby  
Ranking Member

Committee on Banking, Housing, and Urban Affairs  
United States Senate  
Washington, DC 20510

Dear Chairman Dodd and Ranking Member Shelby:

As associations and companies representing nearly every sector of the U.S. economy, as well as nonprofits interested in fostering entrepreneurship, we write to request your support for the inclusion of a provision to S. 3217, "Restoring American Financial Stability Act of 2010," which would permanently exempt smaller companies from Section 404(b) of the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley or SOX).

The Sarbanes-Oxley Act of 2002 placed important new financial reporting requirements on public companies. While many of the requirements included in the bill are considered to have been in the interest of investors and companies alike, Section 404 continues to place a disproportionately negative cost burden on smaller public companies. These cost burdens have the effect of redirecting scarce resources away from job creation and investment.

Section 404(a) of Sarbanes-Oxley requires a public company to include in its annual report management's assessment of the effectiveness of the company's internal control structure and procedures for financial reporting. Section 404(b) requires the company's auditor to attest to, and report on management's assessment. While Section 404 is intended to prevent future accounting improprieties, the implementation of 404(b) has resulted in substantially greater than expected compliance costs, particularly for smaller companies. In fact, according to a 2009 U.S. Securities and Exchange Commission study, Section 404 costs companies an average of \$2.3 million each year in direct compliance costs. Moreover, the study found that the long-term burden on companies with less than \$150 million in public float is greater than seven times that imposed on large firms.<sup>1</sup>

The higher costs incurred by public companies have also had a detrimental impact on initial public offerings (IPOs). According to a 2009 Renaissance Capital report, IPO issuance in 2008 and 2009 is lower than any period since the 1970s when business creation struggled against inflation, high interest rates and the Vietnam War.<sup>2</sup> Additionally, data compiled by Jay Ritter of

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<sup>1</sup> Securities and Exchange Commission, Study of the Sarbanes-Oxley Act of 2002 Section 404 Internal Control over Financial Reporting Requirements, OFFICE OF ECONOMIC ANALYSIS, Table 12, September 2009  
[http://www.sec.gov/news/studies/2009/sox-404\\_study.pdf](http://www.sec.gov/news/studies/2009/sox-404_study.pdf).

<sup>2</sup> Renaissance Capital, How to Heal the IPO Market and Get the Economy Moving,  
<http://www.renaissancecapital.com/IPOHome/Review/HealingIPOs.pdf>

the University of Florida show the number of U.S. IPOs were lower in every year after SOX was enacted in 2002 (2003 to present) than in every year of the decade from 1991 to 2000, including the early '90s recession years. For instance, in the boom post-SOX year of 2006, there were 162 U.S. IPOs. Yet in 1991, a year when the U.S. was mired in recession but did not have SOX, there were 295 U.S. IPOs.<sup>3</sup>

As you know, the House of Representatives passed H.R. 4173, *Wall Street Reform and Consumer Protection Act of 2009*, which includes a provision to permanently exempt smaller companies from Section 404(b). In fact, 101 Democrats voted with their Republican colleagues against an amendment to strip this job creation language from the bill on the House floor. Although there have been arguments made to exempt companies with public floats of up to \$700 million, we believe that given the data from the SEC study and the recent lackluster level of IPOs, the exemption should include companies with public floats of at least \$150 million.

A continuation of the endeavor to permanently exempt smaller companies from Section 404(b) should be sustained in S. 3217, "Restoring American Financial Stability Act of 2010." For this reason, we ask for your support of smaller public companies as the Senate considers its version of financial regulatory reform legislation.

Sincerely,

Biotechnology Industry Organization  
Competitive Enterprise Institute  
TechAmerica  
Association for Competitive Technologies  
Property Casualty Insurers Association of America  
Independent Community Bankers of America  
American Bankers Association  
Advanced Medical Technology Association  
NYSE Euronext  
NASDAQ OMX

cc: Members of the United States Senate

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<sup>3</sup> Ritter, Jay R., Cordell Professor of Finance, University of Florida, Some Factoids about the 2009 IPO Market, <http://bear.warrington.ufl.edu/ritter/IPOs2009Factoids.pdf>