

SEC BEGINS SMALL-BUSINESS COST-BENEFIT STUDY OF SECTION 404 OF THE SARBANES

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On February 1, 2008, the SEC announced that its professional staff has commenced a cost-benefit study of the upcoming auditor attestation requirement for smaller companies under Section 404(b) of the Sarbanes-Oxley Act of 2002.

The study will collect and analyze extensive “real world” cost and benefit data from a broad array of companies currently complying with Section 404 under newly issued guidance for companies and auditors. The new guidance for management and the new auditing standard were intended to reduce the compliance costs of Section 404 while strengthening its focus on material controls. In addition to assessing the Section 404 cost reductions, the final report will also inform any decision to improve the efficiency and effectiveness of Section 404 implementation.

In connection with the study, a four-member commission unanimously proposed on January 31, 2008, the one-year extension of the Section 404(b) auditor attestation requirement for smaller companies that SEC chairman Christopher Cox had previously announced in testimony before the House Small Business Committee in December 2007. The postponement would allow time to complete the study. Under the proposed one-year extension, the Section 404(b) requirements would apply to smaller public companies beginning with fiscal years ending on or after December 15, 2009.

Section 404 has two provisions: 404(a) requires company management to assess the effectiveness of the company’s internal controls over financial reporting, while 404 (b) requires an auditor attestation on management’s assessment. Larger companies have been subject to both provisions since 2004, but with significantly higher costs than were projected when the SEC’s original rules implementing Sarbanes-Oxley were adopted.

To reduce Section 404 costs while preserving its benefits, the SEC last year issued new guidance for management’s Section 404 assessment. The guidance helps companies focus their reviews on the internal control issues that matter most to investors. Companies of all sizes, including smaller companies, will file their first 404 (a) reports using the SEC’s guidance this year.

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The SEC's study will consist of two main parts: 1) a Web-based survey of companies that are subject to Section 404 and 2) in-depth interviews, with companies that are just now becoming compliant. The dual approach will enable the SEC to gather data from a large cross section of companies and analyze more detailed information about what drives costs and where companies and investors derive benefits.

The SEC's Office of Economic Analysis will lead the cost-benefit study with assistance from the Office of the Chief Accountant and Division of Corporation Finance. Recognizing that much of the key financial data will not be available to companies until March or April at the earliest, commission staff expect to complete the study by late summer or early fall.

Public comments on the proposed extension of the auditor attestation requirement for smaller companies should be received by the SEC within 30 days after its publication in the Federal Register. The full text of the detailed proposing release concerning this item will be posted to the SEC Web site as soon as possible.

The SEC has also published an online "plain English" guide to help small businesses comply with Section 404(a) requirements for the first time in their annual reports this year. The small business guide is available at: <http://www.404.gov>.