



Protect Investors in Small Public Companies

Oppose the Garret/Feeney Amendment to the Financial Services Appropriations Act

Dear Representative:

We understand that Rep. Scott Garrett and Rep. Tom Feeney plan to offer an amendment to the Financial Services Appropriations Act for Fiscal Year 2008 to delay yet again implementation of Section 404 of the Sarbanes-Oxley Act for small public companies. We are writing to urge you to vote NO on this anti-investor amendment.

It has been five years since Congress enacted the Sarbanes-Oxley Act, sending the clear message to all public companies that they must improve the accuracy and reliability of their financial statements. While accounting scandals at Enron and Worldcom provided the impetus for passage of the Act, accounting fraud and errors have traditionally been predominantly a small company problem. SOX was designed to address such problems at companies both large and small.

Adopted because many companies had failed to comply with the long-standing requirement that they maintain adequate controls over financial reporting, SOX 404 was designed to add teeth to the law by requiring managers to conduct an annual assessment of their internal controls over financial reporting and by requiring auditors to attest to the adequacy of the company's controls as part of its financial statement audit. Five years after the law was enacted, any public company that has not brought its internal controls up to standard has only itself to blame. Moreover, such companies are doing themselves and their shareholders a grave disservice.

At those companies where it has been implemented, SOX 404 has brought about dramatic improvements. It has uncovered thousands of material weaknesses in internal controls – 1,300 in 2005 and 1,118 in 2006. That drop in material weaknesses between 2005 and 2006 reflected the fact that 404-compliant companies saw a 35 percent drop in material weaknesses. In contrast, non-404-compliant companies saw a 20 percent increase in reported weaknesses. Moreover, most reports of material weaknesses have been accompanied by financial restatements. While restatements decreased 14 percent among 404-compliant companies between 2005 and 2006, they rose a stunning 40 percent among non-404-compliant companies.

Investors pay a hefty price when companies' controls are weak and their financial statements are wrong. For example, companies that reported control weaknesses in 2006 underperformed the Russell 3000 by roughly 18 percent, while those that issued restatements underperformed the Russell 3000 by about 20 percent. This suggests that any savings from non-compliance with SOX 404 are chimerical. In an efficient market, those who are perceived to be at risk of having weak financial reporting will be forced to pay a higher price for capital.

The costs of SOX 404 compliance, meanwhile, have been greatly exaggerated. It has been suggested, for example, that the "average" cost of compliance for a "typical" company is \$4.36 million. If this were in fact typical, it would indeed pose an unreasonable burden for small companies. In reality, however, CRA International found that companies with market caps between \$75 and \$700 million paid only \$0.86 million on average for SOX 404 compliance in the second year of implementation. The smallest public companies had reason to expect even lower costs, even before the Securities and Exchange Commission and Public Company Accounting Oversight Board took steps to ease the standards.

The internal controls requirements of SOX 404 are among the most important protections adopted to address pervasive accounting problems at our public companies. Where they have been implemented, they have brought benefits to shareholders that far outweigh their costs. With additional steps having now been taken to further reduce the cost of implementation, it is long past time that all public companies were brought into compliance. Please vote NO on the Garrett-Feeney amendment.

Respectfully submitted,

Barbara Roper, Director of Investor Protection
Travis Plunkett, Legislative Director
Consumer Federation of America

Ed Mierzwinski, Consumer Program Director
U.S. Public Interest Research Group

Kenneth McEldowney, Executive Director
Consumer Action

Sally Greenberg, Senior Counsel
Consumers Union